



PR 2006/54 - Income tax: Margaret River Watershed Premium Wine Project 2006 (to 15 June 2006)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *12 April 2006*



Product Ruling

Income tax: Margaret River Watershed Premium Wine Project 2006 (to 15 June 2006)

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ⓘ This Ruling 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 'taxation 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 sometimes referred to as the Margaret River Watershed Wine Project 2006 or simply as 'the Project'.

Relevant taxation provisions

2. The taxation 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;
 - 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 70 of the ITAA 1997;
 - section 108-5 of the ITAA 1997;
 - Division 110 of the ITAA 1997;
 - Division 328 of the ITAA 1997;
 - Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
 - section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KL of the ITAA 1936;
 - section 82KZME of the ITAA 1936;
 - section 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. 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 participants are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies consists of the entities who are more specifically identified in the Ruling part of this Product Ruling, refer to paragraphs 55 to 56, and who enter into the scheme specified below on or after the date this Ruling is made. They 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. In this Ruling these entities are referred to as 'Growers'.

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

- entities who intend to terminate their involvement in the scheme prior to Project's completion or do not intend to derive assessable income from the Project;
- entities who participate in the Project through offers made other than through the Product Disclosure Statement; and
- Watershed Premium Wines Limited and its associates.

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 15 to 54.

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 12 April 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.

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)). If a private ruling is inconsistent with a later Product Ruling, the earlier 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.

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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the tax law(s) 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

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

- Application for Product Ruling constituted by documents provided on 16 September 2005, 22 September 2005, 27 September 2005, 1 November 2005, 3 January 2006, 21 January 2006, 8 February 2006, 9 February 2006, 20 February 2006, 21 February 2006, 20 March 2006, 23 March 2006, 24 March 2006, 26 March 2006 and 4 April 2006 and additional correspondence dated 22 September 2005, 27 September 2005, 1 November 2005, 3 January 2006, 21 January 2006, 25 January 2006, 30 January 2006, 1 February 2006, 8 February 2006, 9 February 2006, 20 February 2006, 21 February 2006, 20 March 2006, 23 March 2006, 24 March 2006, 26 March 2006, 31 March 2006 and 4 April 2006;
- Draft Product Disclosure Statement/Prospectus of the Margaret River Watershed Premium Wine Project 2006, received 26 March 2006;
- Draft **Constitution** for the Margaret River Watershed Premium Wine Project 2006 between Watershed Premium Wines Limited ('Responsible Entity') and the Grower, received 4 April 2006;
- Draft **Project Operations Agreement for 2006 Growers** ('Project Operations Agreement') of the Margaret River Watershed Premium Wine Project 2006 between the Responsible Entity and the Grower, received 4 April 2006;
- Option to Purchase Property between the owners and Watershed Land Limited, received 16 September 2005;
- Draft Interim Head Lease between the owners and Watershed Land Limited, received 8 February 2006;

- Draft **Lease and Sub-Lease for 2006 Growers** ('Sub-Lease') between Watershed Land Limited, the Responsible Entity and the Grower, received 4 April 2006;
- Draft Standing Offer – Lease for 2006 Growers between Watershed Land Limited and the and the Responsible Entity, received 16 September 2005;
- Draft Standing Offer – Project Operations Agreement for 2006 Growers between Watershed Premium Wines Limited ('Manager') and the and the Responsible Entity, received 16 September 2005;
- Compliance Plan for the Margaret River Watershed Premium Wine Project, received 16 September 2005;
- Viticulture Consultant's Report, dated 23 September 2005;
- Watershed 2006 Vintage Fruit ('Vintage Plan'), received 1 November 2005;
- Watershed Premium Wines Vineyard Program Month by Month ('Vineyard Management Plan'), received 1 November 2005;
- Independent Wine Marketing Report, dated February 2006; and
- Draft **Terms Agreement for 2006 Terms Growers**, between the Responsible Entity and the Grower, received 16 September 2005.

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

16. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the scheme to which this Ruling applies.

17. All Australian Securities and Investments 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

18. This scheme is called the Margaret River Watershed Premium Wine Project 2006.

Location	South West Region of Western Australia, South of Margaret River.
Type of business each participant will be carrying on	A commercial viticulture and wine production business.
Number of hectares under cultivation	60 hectares
Size of each Vinelot	0.025 hectares
Number of vines per hectare	1,640
Expected production	10 tonnes (720 cases) of Wine per hectare per year
The term of the investment	18 years
Initial cost	\$3,608 per Vinelot (plus \$1,716 subscription to 528 shares in Watershed Land Limited)
Ongoing costs	Annual Management Fees and Rent

19. The Margaret River Watershed Premium Wine Project 2006 is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is Watershed Premium Wines Limited. The Responsible Entity has been issued with Financial Services Licence Number 296166 by ASIC.

20. The Project Land is situated in the South West Region of Western Australia, along Adams Road in Jindong within the Margaret River appellation.

21. Growers applying under the PDS/Prospectus ('PDS') enter into a Sub-Lease with Watershed Land Limited, to lease or sub-lease to the Grower an identifiable area of the Project Land called a 'Vinelot'. Each Vinelot is 0.025 hectares in size.

22. Growers will also enter into a Project Operations Agreement to engage the Responsible Entity to develop and manage the Vinelots and Harvest the Grapes from the Vinelots. As required, the Responsible Entity will purchase Grapes to supplement the Grapes produced from the Vinelots. In addition, the Responsible Entity will arrange the Wine production, marketing, and sale of the Wine.

23. The PDS states that there is no minimum subscription for the Project. Each investor may subscribe for a minimum of one Vinelot.

24. Each Vinelot carries a requirement for the purchase of 528 Land Shares, at a cost of \$3.25 per share, in Watershed Land Limited. The Land Shares can be held by any entity and can be held in a different name from the Grower carrying on their business on the Vinelot.

25. This Product Ruling only applies to Growers who are accepted into the Project on or after the date of this Ruling and on or before 15 June 2006. Another Product Ruling will issue for Growers who are accepted into the Project after 30 June 2006 and on or before 15 March 2007.

Constitution

26. The Constitution establishes the Project and operates as a deed binding on the Growers and the Responsible Entity. Clause 5 of the Constitution sets out the terms and conditions under which Watershed Premium Wines Limited agrees to act as the Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project (clause 3.2).

27. Clause 3.3 of the Constitution provides that on being accepted in the Project, Growers become a party to and are bound by the Sub-Lease and the Project Operations Agreement.

28. The Application Money for Vinelots ('Application Money') will be held in a trust account by the Responsible Entity in its capacity as 'Bare Trustee' (clause 3.4). The Application Money may only be released for the purpose of discharging the Grower's obligations pursuant to the to the Project agreements and where:

- the Responsible Entity has the capacity to grant a lease of a Vinelot(s) to the Applicant;
- the Sub-Lease and Project Operations Agreement are in the proper form;
- all matters necessary for the creation of the Sub-Lease and the Project Operations Agreement have been entered into; and
- there are no outstanding breaches of the Constitution which are detrimental to the interests of the Applicant (clause 6(a) and (c)).

29. A Grower's Receipts from the Project will be payable to the Bare Trustee and will be deposited into the Trust Account. The Receipts include any of the Grower's insurance proceeds and proceeds received from the sale of the Wine (clause 8 and 12).

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

- requirement that the Compliance Plan will be executed and lodged with ASIC (Clause 6(bb));
- complaints handling methods (clause 13.1); and
- period and termination of the Project (clause 15).

Compliance Plan

31. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. 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 Growers are protected.

Sub-Lease

32. Watershed Land Limited has exercised an option to purchase Project Land, with settlement due on 30 September 2006. Prior to the allotment of the first Vinelot, Watershed Land Limited entered into an Interim Head Lease with the vendors, for the period to 30 September 2006. The Interim Head Lease and the eventual ownership of the land will enable Watershed Land Limited to lease the Vinelots to the Growers for the full Project Term.

33. Under the Sub-Lease, Watershed Land Limited provides that it will plant Vines on the Vinelot at an average over all Vinelots of at least 1,640 Vines per hectare (clause 7.5).

34. Watershed Land Limited will ensure that there is sufficient water available to the Grower for the cultivation of the Vines (clause 7.4).

35. The Sub-Lease also provides that the Grower shall be entitled to the Grapes produced from the Grower's Vinelot(s) (clause 2.4).

Project Operations Agreement

36. Each Grower enters into a Project Operations Agreement with the Responsible Entity. Growers contract with the Responsible Entity to manage, maintain and Harvest Grapes from the Vines and to produce, store and market Wine on their behalf.

37. In return for the Management Fees set out in Part 2 of the Schedule the Responsible Entity will carry out the following services.

38. In the Initial Period, being the period from the Commencement Date to 30 June 2006 the Responsible Entity will carry out the services set out in clause 5.2, which include:

- purchase of 60 litres of red Wine for each Grower;
- produce and bottle three cases of white Wine for each Grower;
- maintain the fences on the Vinelot;
- do such things as may reasonably be required to eradicate, exterminate and keep the Vinelots and the Land free from disease, vermin, noxious weeds and pests;
- to secure the entry ways to the Land against trespass by unauthorised persons;
- arrange for the delivery of Wine purchased on behalf of the Grower to the Winery as per clause 9;
- carry out the brand marketing strategy and carry out the distribution and sale of the Wine; and
- to provide services of an administrative nature (clause 5.2).

39. In the Ongoing Period commencing on 1 July 2006, the Responsible Entity will carry out the services set out in clause 5.3, which include:

- cultivate and maintain the Vines on the Vinelots in a proper and skilful manner pursuant to the Vineyard Management Plan;
- tend to the Vines according to the principles of sound viticulture practice, including the application of fertiliser;
- maintain and/or upgrade fences on the Vinelot;
- keep the Vinelots in good and substantial repair and condition and conduct activities on them in a commercial manner in keeping with accepted viticulture industry standards;
- do such things as may reasonably be required to eradicate, exterminate and keep the Vinelots and the Land free from disease, vermin, noxious weeds and pests;
- take such steps as are required to comply with the provisions of the *Bush Fires Act 1954*;
- to secure the entry ways to the Land against trespass by unauthorised persons;

- arrange for the delivery of harvested Grapes and any other Wine or Grapes purchased on behalf of the Grower to the Winery for the production of Wine from those grapes, as per clause 9;
- to maintain dams and water supply pumps and irrigation supplies to ensure the water supply is adequate at all times for Viticulture Farming;
- carry out the brand marketing strategy and carry out the distribution and sale of the Wine;
- to produce and bottle Wine as set out in Part 3 of the Schedule, which includes producing and bottling 4.5 cases of white Wine per Vinelot in the year ended 30 June 2008 and producing and bottling 18 cases of Wine per Vinelot for each financial year commencing on 1 July 2008 and ending on 30 June 2024; and
- to provide services of an administrative nature.

40. The Responsible Entity will be responsible for paying for the cost of a public risk insurance policy as described in clauses 5.2(g) and 5.3(m). Insurance coverage will also be kept against:

- damage or destruction caused by hail, fire, malicious damage, lightning and explosions on a Grower's Vinelot for the Initial Period and Year 1; and
- the destruction of and the damage from usual risks in respect of a Grower's Wine (clause 12).

41. Clause 7 provides that a Harvest will take place each Season (except for the initial growing Seasons) as and when deemed appropriate by the Responsible Entity.

Pooling of Grapes and Wine and distribution of proceeds

42. The Project Operations Agreement sets out the circumstances relating to the pooling of Growers' Grapes and Wine and the distribution of proceeds from the sale of the processed Wine. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed Grapes and/or Wine to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and
- Grapes and Wine can only be pooled with the Grapes and Wine of Growers who are accepted to participate in the Margaret River Premium Wine Project 2006.

43. The proceeds from the pool will be distributed to the Growers in each financial year. The Grower's share of the pool is based on the proportion of the Vinelots they lease in relation to total number of Vinelots leased under the Project.

44. However, before the distribution, the proceeds will be reduced by any outstanding fees, costs and expenses (clause 12 of the Constitution).

45. In addition, the Grower's entitlement in relation to the sales proceeds will be reduced accordingly in the event of total or partial destruction of the Vines on their Vinelots (clause 13 of the Project Operations Agreement).

Fees

Application money

46. Application Money of \$3,608, per Vinelot, is payable on or before 15 June 2006. The Application Money consists of:

- \$3,410 for Management Fees, for services to be performed during the period from the Commencement Date to 30 June 2006 (Part 2 of the Schedule to the Project Operations Agreement); and
- \$198 for Rent for the year ending 30 June 2006 (Part 5 of the Schedule to the Sub-Lease).

Shares

- \$1,716 for 528 fully paid Land Shares is payable on or before 30 June 2006, together with the Application Money above.

Ongoing Management Fees

- \$3,223 payable on or before 1 April 2007, for services to be carried out in the period 1 July 2006 to 30 June 2007 (Part 2 of the Schedule to the Project Operations Agreement);
- \$3,520 payable on or before 1 April 2008, for services to be carried out in the period 1 July 2007 to 30 June 2008 (Part 2 of the Schedule to the Project Operations Agreement); and
- the Prescribed Portion of the actual costs, plus profit for each income year commencing on 1 July 2008 to 30 June 2023, payable on or before 1 April in each relevant income year, commencing on 1 April 2009 (clause 4.3 of the Project Operations Agreement).

Ongoing Rent

- \$198 (indexed) for each income year for the Project Term, commencing on 1 July 2006 and payable on or before 1 April in each relevant income year, commencing on 1 April 2007 (Part 5 of the Schedule to the Sub-Lease).

Finance

47. A Grower who does not pay the 'Application Money' in full upon application or who does not receive an approval to pay its fees under the Terms Payment Option (see below), can borrow from an independent lender external to the Project. The only finance arrangement covered by this Product Ruling is the Terms Payment Option set out in paragraphs 49 to 53. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under that finance arrangement not covered by this Product Ruling.

48. Other than where the Application Money is paid under a Terms Payment Option, Growers cannot rely on any part of this Ruling if the Application Money, is not paid in full on or before 15 June 2006 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted and that application is subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the Grower or relevant lending institution on or before 15 June 2006.

Terms Payment Option

49. Under the PDS, a Grower can choose to pay the Application Money and amount for shares in full on the due date, or pay the amount under the Terms Payment Option offered by the Responsible Entity. The following payments are due under this option:

- Deposit of \$2,716 with the application on or before 15 June 2006 (\$1,000 per Vinelot and \$1,716 for the Land Shares); and
- \$2,964 per Vinelot payable in 12 equal monthly instalments of \$247 (including interest at 11.5% per annum).

50. The total amount payable under the Terms Payment Option includes an application fee of \$50 per Vinelot.

51. Growers who choose to pay under the Terms Payment Option must complete a Terms Application and Direct Debit Request. A Terms Agreement will be executed by the Responsible Entity.

52. The monthly instalments are paid by direct debit commencing on the last business day of July 2006 (clause 2.4 of the Terms Agreement).

53. If a Grower does not pay the required instalments under the Terms Payment Option, the balance of principal, interest and any additional costs payable under the option becomes immediately due and payable to the Responsible Entity. In addition, the Responsible Entity may take legal action to recover the amounts due and may take possession of the Grower's Vinelot (clause 9.2 of the Terms Agreement).

Other qualifications relating to finance arrangements

54. 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, are involved or become involved in the provision of finance to Growers for the Project, other than under the Terms Payment Option offered by the Responsible Entity described in paragraphs 49 to 53.

Ruling

Application of this Ruling

55. Subject to paragraph 8, this Ruling applies only to Growers who are accepted to participate in the Project:

- on or before 1 June 2006; or
- during the period 2 June 2006 to 15 June 2006 (provided the Responsible Entity can wholly provide the services in consideration for the application money by 30 June 2006).

56. The Grower must have executed the Sub-Lease and Project Operations Agreement. A Grower's participation in the Project must constitute the carrying on of a business.

57. 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.

The Simplified Tax System (STS)

Division 328

58. 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 under the STS where a Grower who was an STS taxpayer prior to the 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*.

59. 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

60. 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

61. That part of the Receipts from the Project attributable to the sale of the Grower's Wine, less any GST payable on those Receipts (section 17-5), will be assessable income of the Grower under section 6-5.

62. The Grower recognises ordinary income from carrying on the business of viticulture and wine production at the time that income is derived.

Deductions for Management Fees, Rent, interest and borrowing costs**Sections 8-1 and 25-25**

63. A Grower may claim tax deductions for the revenue expenses specified in the following Table.

64. The deductions set out in the Table below will be allowable on a per Vinelot basis:

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Management Fees	\$3,410 See Note (i)	\$3,223 See Notes (i) & (iii)	\$3,520 See Notes (i) & (iii)
Rent	Amount must be calculated See Notes (i) & (ii)	\$198 (indexed) See Notes (i) & (iii)	\$198 (Indexed) See Notes (i) & (iii)
Interest incurred by Growers paying under the Terms Payment Option	Nil See Note (iv)	\$306 See Note (iv)	Nil See Note (iv)
Application Fee for Growers paying under the Terms Payment Option	May need to be calculated See Note (v)	May need to be calculated See Note (v)	May need to be calculated 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) For the year ended 30 June 2006 the Rent of \$198 is not deductible in full under section 8-1 as part of the Rent is capital in nature (see paragraph 94). The Rent of \$198 payable on or before 30 June 2006 is only deductible to the extent of \$16.50 per month – from and including the month that the Grower first leases the land up to 30 June 2006.

- (iii) This Ruling does not apply to a Grower who chooses to prepay Management Fees or Rent or who chooses, or who is required to prepay interest under a loan agreement (see paragraphs 95 to 97). Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (iv) The deductibility or otherwise of interest arising from finance arrangements other than a Terms Payment Option with the Responsible Entity is outside the scope of this Ruling. A Grower who enters into a finance arrangement other than the Terms Payment Option may request a private binding ruling on the deductibility of the interest incurred.
- (v) The 'Loan Application Fee' payable to the Responsible Entity under the Terms Payment Option is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the borrowing expense exceeds \$100 the deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from finance arrangements other than the Terms Payment Option is outside the scope of this Ruling.

Shares

65. The shares in Watershed Land Limited are CGT assets (section 108-5) and the amounts paid by a Grower to acquire the shares are an outgoing of capital and not allowable as a deduction.

66. The amounts paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

67. Any dividends paid out of profits by Watershed Land Limited will be assessable income of the shareholder under subsection 44(1) of the ITAA 1936.

Trading stock

Section 70-35

68. A Grower who is not an STS taxpayer will, in some years, hold 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 Grower must include the amount of that excess in assessable income.

69. 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 Grower may claim the amount of that excess as an allowable deduction.

70. The Responsible Entity will advise the Grower of the value of trading stock on hand at the end of the year.

Section 328-285

71. A Grower who is an STS taxpayer may, in some years, hold Wine that will constitute trading stock on hand. Where, for such a Grower, 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)).

72. Alternatively, a Grower 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)).

73. The Responsible Entity will advise the Grower of the value of trading stock on hand at the end of the year.

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

Section 35-55 – Commissioner's discretion

74. A Grower who is an individual accepted into the Project 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 the income years ending **30 June 2006 to 30 June 2008** for Growers accepted in the Project on or before 15 June 2006. 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

75. For a Grower who participates in the Project and incurs expenditure as required by the Sub-Lease and Project Operations 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.

Commissioner of Taxation12 April 2006

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?

76. For the amounts set out in the Table above to constitute allowable deductions the Grower's viticulture activities as a participant in the Margaret River Watershed Premium Wine Project 2006 ('Project') 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.

77. For schemes such as that of the Project 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 Taxation Ruling 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.

78. 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 rights over the land (by licence) 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.

79. In this Project, each Grower enters into a Sub-Lease and a Project Operations Agreement.

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

81. Under the Project Operations Agreement, the Responsible Entity is engaged by the Grower to establish and maintain a Vinelot(s) 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 Vinelot on the Grower's behalf.

82. The Grower engages the Responsible Entity to maintain the Vines on the Vinelot(s) according to the principles of sound viticulture practice, which includes irrigation, fertilisation, weed control and pruning. The Responsible Entity is also engaged to harvest, on the Grower's behalf, the Grapes grown on the Grower's Vinelot. The Grapes are produced into Wine and then sold, again on the Grower's behalf.

83. 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.

84. 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 Wine that will return a before-tax profit, which is a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

85. The pooling of Grapes grown on the Grower's Vinelot with the Grapes of other 2006 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 Vinelot.

86. The Responsible Entity's services are consistent with general viticultural practices. While the size of a Vinelot is relatively small, together with the associated Wine production operation, it is of a size and scale to allow it to be commercially viable.

87. The Grower's degree of control over the Responsible Entity as evidenced by the Project Operations 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 Vinelot 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 cases of default or neglect.

88. 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 Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

89. 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.

90. 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 Management Fees and Rent

Section 8-1

91. Consideration of whether the Management Fees and 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 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.

92. The Management Fees associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture and hence have a sufficient connection to the operations by which income (from the regular sale of Wine) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the scheme. The fee appears to be reasonable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions under section 8-1 do not apply.

93. 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.

94. The Commissioner is of the view that a portion of the Rent payable on or before 30 June 2006 is capital, or capital in nature. The Rent payable relates to a full year, however, the Grower does not lease the land for a full income year in the Initial Period. Therefore, it is considered that part of the Rent is a premium paid by the Grower for the grant of the lease and is capital in nature. Due to this conclusion, the Rent payable on or before 30 June 2006 is not deductible in full, however, a partial deduction of \$16.50, calculated on a pro-rata monthly basis for each month that a Grower leases the land, will be an allowable deduction in the Initial Period.

Prepayment provisions

Sections 82KZL to 82KZMF

95. The prepayment 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 (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

96. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Project Operations Agreement and/or the Sub-lease or prepays interest under a loan agreement with an external financier. Where such a prepayment is made the prepayment provisions will also apply to STS taxpayers because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

97. As noted in the Ruling section above, a Grower who prepays fees or interest is not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

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

98. The Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses, in deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2006 to 30 June 2008**.

99. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2006 up to and including 30 June 2008:

- 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.

100. 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 – recouped expenditure

101. 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 of the ITAA 1997.

Part IVA – general tax avoidance provisions

102. 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).

103. 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 paragraph 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.

104. 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 their Wine. 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.

Appendix 2 – Detailed contents list

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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:

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

Legislative references:

- TAA 1953
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