



PR 2007/46 - Income tax: Palandri Global Supply Challenge 2007-2008 (2007 Growers using finance from Allco Managed Investment Limited)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 May 2007*



Product Ruling

Income tax: Palandri Global Supply Challenge 2007-2008 (2007 Growers using finance from Allco Managed Investment Limited)

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❗ 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. 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.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the 'Palandri Global Supply Challenge 2007-2008' or simply as the 'Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Growers.

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 29 on or before 15 June 2007. They must, fund their participation in the Project using finance provided by Allco Management Investment Limited (Momentum), 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.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities who:

- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 15 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- have their application conditionally accepted by Palandri Wines Ltd subject to finance for the payment of the application fee, where finance has not been approved by the lender or finance has been approved and the funds have not been made available to Palandri Wines Ltd by 15 June 2007; or
- enter into finance arrangements with entities other than Momentum.

Superannuation Industry (Supervision) Act 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

6. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 29 to 78 of this Ruling.

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

- this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

9. This Product Ruling applies prospectively from 23 May 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 23 May 2007 until 15 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities up to 30 June 2009.

10. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or

- the relevant provisions are not amended.

11. 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)).

12. 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.

13. 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).

Changes in the law

14. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to the extent of those amendments this Product Ruling will be superseded.

15. Entities who are considering participating in the scheme 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

16. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes 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 Product Ruling is issued.

Goods and Services Tax

17. All fees and expenditure referred to in this Product Ruling include the 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.

Ruling

Application of this Ruling

18. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 29 to 78 of this Ruling.

19. The Grower's participation in the Project must constitute the carrying on a business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Lease and Management Agreement, on or before 15 June 2007.

The Simplified Tax System (STS)

Division 328

20. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS taxpayer' and must have elected to 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*.

21. 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

22. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides a 25% tax offset 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**

23. 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.

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

Deduction for Maintenance Services Fees, rent, interest and borrowing expenses**Section 8-1, section 25-25 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936**

25. 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	2006-07 Income Year	2007-08 Income Year	2008-09 Income Year
Initial Maintenance Services Fee	\$2,557.50 See Notes (i) and (ii)	Nil	Nil
Ongoing Maintenance Services Fee (Growers acquiring one Vineyard Lot)	\$990 See Notes (i), (iii) and (vi)	Nil	Nil
Ongoing Maintenance Services Fee (Growers acquiring multiple Vineyard Lots)	Nil	\$495 See Notes (i), (iii) and (vi)	\$495 See Notes (i), (iii) and (vi)
Rent	Nil	See Notes (i), (iv) and (vi)	See Notes (i), (iv) and (vi)
Interest on loans with Momentum	Nil	See Notes (v) and (vi)	See Notes (v) and (vi)
Borrowing Expenses	See Note (vii)	See Note (vii)	See Note (vii)

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 fee for Initial Maintenance Services to be provided in the Initial Maintenance Period is deductible under section 8-1 in the year that it is incurred.
- (iii) The Lease and Management Agreement requires Growers to prepay Ongoing Maintenance Services Fees for the Second and Third Maintenance Periods. A Grower who acquires one Vineyard Lot will incur prepaid Ongoing Maintenance Services Fees of \$990. This amount will be deductible in full under section 8-1 in the year it is incurred as it is 'excluded expenditure'. (Refer to paragraphs 90 to 97 of this Ruling for a discussion of the prepayment provisions). However if more than one Vineyard Lot is acquired then the amounts will be apportioned, according to the formula in subsection 82KZMF(1) of the *Income Tax Assessment Act 1936* (ITAA 1936). Section 82KZMF operates to apportion expenditure over the eligible service period or 10 years, whichever is the lesser. The 'eligible service period' commences on 1 July 2007 and ends on 30 June 2009. Accordingly, for each Vineyard Lot, an amount of \$495 is deductible in each of the 2007-08 and 2008-09 income years.
- (iv) Rent is not payable in the Initial Maintenance Period. The rent for the Second and Third Maintenance Periods is deferred and taken as 2% of Gross Harvest Proceeds over the life of the Project beginning at the end of the first income year in which there is a harvest. Rent is fully deductible under section 8-1 in the year that it is incurred.
- (v) Subject to the prepayment provisions in Note (vi) below, interest paid to Momentum is deductible under section 8-1 in the year in which it is incurred.
- (vi) This Ruling does not apply to Growers who choose to prepay Ongoing Maintenance Services fees and rent for the 2009-10 and subsequent income years or who choose to, or are required to prepay interest under a loan agreement. Subject to certain exclusions, 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.

- (vii) The loan application fee and stamp duty payable to Momentum 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.

Deductions for capital expenditure

Division 40 and Division 328

26. A Grower will be entitled to tax deductions relating to the irrigation system and the establishment of the grapevines. Deductions shown in the following Table are determined under Division 40. 'STS taxpayers' may choose to calculate the deduction for the irrigation system under Division 328 (see Note (viii) below).

Fee type	ITAA 1997 section	2006-07 Income Year	2007-08 Income Year	2008-09 Income Year
Water facility	40-515	\$137.50 See Notes (i) & (viii)	\$137.50 See Notes (i) & (viii)	\$137.50 See Notes (i) & (viii)
Establishment of horticultural plants (grapevines)	40-515	Nil see Note (ix)	Nil see Note (ix)	Nil see Note (ix)

Notes:

- (viii) The irrigation system meets the definition of 'depreciating asset' in section 40-30 and 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) for the capital expenditure incurred by each Grower on the installation of the irrigation system. This deduction is equal to one third of the capital expenditure in the year in which it is incurred and one third in each of the next two years of income (section 40-540).

STS taxpayers may choose to calculate their deduction under Division 40 (as discussed above) or under Division 328. 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 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 2006-07 income year 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).

- (ix) 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 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 and the amount that may be claimed.

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

Section 35-55 – exercise of Commissioner's discretion

27. A Grower who is an individual accepted into the Project by 15 June 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 below, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the **2006-07 to 2009-10 income years**. 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

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

- 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.

Scheme

29. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling received 28 September 2006 as constituted by the following documents and additional correspondence including emails received 21 November 2006, 14 December 2006, 22 December 2006, 17 January 2007, 2 February 2007, 5 February 2007, 23 March 2007 and 18 April 2007;
- Product Disclosure Statement (PDS) for the Palandri Global Supply Challenge 2007-2008, dated 2 February 2007;
- Supplementary Product Disclosure Statement, dated 22 March 2007;
- Draft Constitution for the Palandri Global Supply Challenge 2007-2008, received 28 September 2006;
- Draft **Lease and Management Agreement** between Palandri Wines Ltd (as Lessor and Responsible Entity) and the Grower, received 28 September 2006;
- Draft Operational Management Agreement between Palandri Wines Ltd (as Responsible Entity) and Palandri Investment Management Ltd (as Operational Manager), received 28 September 2006;
- Draft Initial and Ongoing Services Agreement between Palandri Wines Ltd (as Responsible Entity) and Palandri Project Management Ltd (the Manager), received 28 September 2006;
- Draft Operations Agreement – Establishment Services between Palandri Wines Ltd (as Responsible Entity) and Palandri Project Management Ltd, received 28 September 2006;
- Draft Grape Supply Agreement between Palandri Wines Ltd (as Responsible Entity) and Palandri Wine Production, received 28 September 2006;
- Draft Compliance Plan for Palandri Global Supply Challenge 2007-2008, received 28 September 2006;

- Draft Option Agreement for the purchase of Frankland River Vineyard 2 between Palandri Wine Production Ltd and Palandri Wines Ltd received 28 September 2006;
- Draft Head Lease for the Frankland River Vineyard 2 between Palandri Wine Production (Head Lessor) and Palandri Wines Ltd (Responsible Entity), received 14 December 2006;
- Draft Head Lease for the Frankland River Vineyard 1 between Palandri Wine Production (Head Lessor) and Palandri Wines Ltd (Responsible Entity), received 14 December 2006;
- Draft Option Agreements for the purchase of the Cookernup properties between the Vendors and Palandri Wines Ltd (as Trustee for the Palandri Agricultural Property Trust), received 28 September 2006;
- Draft Leases for the Cookernup properties between the Palandri Agricultural Property Trust and Palandri Wines Ltd (as Responsible Entity), received 16 May 2006;
- Draft Head Lease for the Margaret River Vineyard between Palandri Ltd (Head Lessor) and Palandri Wines Ltd (Responsible Entity), received 17 January 2007;
- Draft Option Agreement between the Vendor and Palandri Wines Ltd (as Responsible Entity and Trustee for the Palandri Agricultural Property Trust), received 23 March 2007; and
- Finance Package for Allco Managed Investment Limited (Momentum) including **Loan Agreement** and loan application documents, received 23 March 2007.

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

30. The documents highlighted (in bold) 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.

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

Overview

32. The main features of the Palandri Global Supply Challenge 2007-2008 are as follows:

Location	The South West wine region of Western Australia
Type of business to be carried on by each participant	Commercial growing of wine grapes for the purpose of harvesting and selling the produce
Number of hectares offered for cultivation	368 hectares
Size of each Vineyard Lot	0.05 hectares comprising 0.025 hectares of reworked vineyard and 0.025 hectares of new vineyard
Number of vines per hectare	Approximately 1,667
Term of the Project	18 years
Initial Cost per Vineyard Lot	\$3,960 (this includes an amount for prepaid fees)
Ongoing and other costs	<ul style="list-style-type: none"> • annual rent, partly deferred; • annual Ongoing Maintenance Services Fees; • harvest and sale costs; • optional Insurance of vines; and • contingency fee as required.

33. The Project has been registered as a Managed Investment Scheme under the *Corporations Act 2001*. Palandri Wines Ltd has been issued with Financial Services Licence Number 247359 and will be the Responsible Entity for the Project. It is intended that Palandri Wines Ltd will retire as Responsible Entity and Palandri Investment Management Ltd (the Manager) will be appointed Responsible Entity subject to authorization by ASIC and approval by extraordinary resolution of Growers.

34. The Project involves the cultivation of grapevines and the harvest and sale of the grapes.

35. 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. Each Vineyard Lot consists of two separate parcels of land of 0.025 hectares each. One parcel will contain an established vineyard which will require either radical pruning or grafting, while the other parcel has not been established. The Vineyard Lots will be planted at the rate of approximately 1,667 vines per hectare.

36. An offer to participate in the Project will be made through a PDS. The offer made under the PDS is for 368 hectares which corresponds to 7,360 Vineyard Lots in the Project. There is no minimum subscription for the Project.

37. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Palandri Wines Ltd to enter into, on behalf of the Grower, a Lease and Management Agreement and any other documents required to hold an interest in the Project.

38. The Project will be conducted on land located in the Harvey, Frankland River, Margaret River and Jindong regions in the South West of Western Australia.

39. The Harvey property is located at Cookernup, in the Shire of Harvey. Specifically the property is described as Lot 135 Cnr Thompson Road and Brockman Road, Cookernup; Lot 136 Cnr Hayward Street and Brockman Road, Cookernup; and Lot 306 Hayward Street, Cookernup. There are currently options to purchase the land between the vendors and Palandri Wines Ltd (as Trustee for the Property Trust). The Property Trust will lease the properties to the Responsible Entity for the term of the Project.

40. The properties in the Frankland region (referred to as Frankland River 1 and Frankland River 2) comprise Hay Location 2088, Vol 3079, Folio 334; Hay Location 2110, Vol 3079, Folio 400; Hay Location 2109, Vol 1259, Folio 379; and Hay Location 2111, Vol 3079, Folio 401. The Responsible Entity has an option to purchase Frankland River 2 from Palandri Wine Production Ltd. Frankland River 1 is will be leased from the owner by Palandri Wine Production Ltd. Palandri Wine Production Ltd will lease Frankland River 1 and Frankland River 2 to the Responsible Entity.

41. The Margaret River property (known as Margaret River Vineyard) is owned by Palandri Ltd and leased to the Responsible Entity. The property is described as Lot 3828 on deposited Plan 157551 being the whole of the land in Certificate of Title Volume 1316, Folio 868.

42. The Jindong property is located in Jindong within the Shire of Busselton. The property covers 67 hectares (50 hectares of which will be planted with new vines) and is currently unplanted. The property is comprised of Sussex Locations 3114 and 3118 being the land comprised in Certificate of Title Volume 2166 Folio 191. The Responsible Entity will enter into an option to purchase with the current owner of the land.

43. The above properties will be established by the Responsible Entity at its own cost. The work includes the following:

- commence the construction of trellising and irrigation;
- conduct soil and hydrology test;
- deep fertilise the site;

- undertake land preparation, dam construction and site surveys; and
- plant or graft the Vines.

44. Planting and grafting will be carried out after the Land has been sub-leased to the Grower and will be completed by 30 September 2007, subject to suitable weather conditions, but in any event no later than 30 November 2007.

45. Under the Operations Agreement – Establishment Services, the Responsible Entity engages Palandri Project Management Pty Ltd as subcontractor to carry out the above Establishment Services.

46. This Ruling only applies to Growers who:

- **are accepted into the project during the period from 23 May 2007 to on or before 15 June 2007; and**
- **fund their participation in the Project using finance provided by Momentum.**

47. Product Ruling PR 2007/10 may apply to Growers who enter the Project during the period from 21 February 2007 to on or before 15 June 2007 and do not enter into finance arrangements with Momentum.

Constitution

48. The Constitution establishes the Project and operates as a deed binding on all Growers and Palandri Wines Ltd. The Constitution sets out the terms and conditions under which Palandri Wines Ltd agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project.

49. In order to acquire an interest in the Project, the Grower must make an application for a Vineyard Lot(s) in accordance with clause 6. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the registered office of the Responsible Entity and accompanied by the payment of the Application Money in a form acceptable to the Responsible Entity.

50. Under clause 13 of the Constitution, the Responsible Entity holds the Application Money on bare trust. The Responsible Entity will deposit all Application Moneys received from applicants in an Application Fund in the name of the Responsible Entity.

51. Once the Responsible Entity has accepted the Grower's application and the Lease and Management Agreement has been executed and remains in force, the Application Money may be transferred and applied against the fees due to the Responsible Entity (clause 14).

52. In summary, the Constitution also sets out provisions relating to:

- register of Growers, clause 8;
- Growers' income and distributions, clause 15;

- appointment of agents, clause 19;
- complaints handling, clause 21; and
- winding up the Project, clause 28.

Compliance Plan

53. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. Its purpose 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 and Management Agreement

54. Growers participating in the scheme will enter into a Lease and Management Agreement with Palandri Wines Ltd in its capacity as Responsible Entity of the Palandri Global Supply Challenge 2007-2008. Growers are granted an interest in the Vineyard in the form of a sub-lease to use their Vineyard Lot for the purpose of conducting their viticulture business upon the terms and conditions as set out in the agreement.

55. The Lease will commence on the date the Vineyard Lots are allotted to Growers and will continue for a period of approximately 18 years or until the Project is terminated.

56. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement.

57. Schedule 3 Item A (Initial Maintenance Services) and Schedule 3 Item B (Ongoing Maintenance Services) of the Lease and Management Agreement specify the services to be performed by the Responsible Entity.

58. The Initial Maintenance Services will be performed during the Initial Maintenance Period, from the Commencement Date to 30 June 2007.

59. Initial Maintenance Services include:

- tend, fertilise and care for the Vineyard Lots, including pruning of any vines thereon, in accordance with good viticultural practice;
- supervise, inspect and manage any maintenance activities conducted by subcontractors;
- control weeds, pests, vermin, and diseases;
- maintain plant and equipment; and
- maintain roads, fences, irrigation equipment, entryways, firebreaks, drainage and water catchment systems.

60. During the Initial Maintenance Period the Responsible Entity must also install the irrigation systems and infrastructure necessary to maintain the Grower's Vineyard Lot.

61. The Ongoing Maintenance Services will be performed during each subsequent Maintenance Period. The Second and subsequent Maintenance Periods comprise each income year from 1 July 2007 to 30 June 2024.

62. Ongoing Maintenance Services include:

- inspect all completed planting and pruning to ensure the Vineyard Lot is of the quality required by the Manager;
- cultivate, tend, prune, fertilise and otherwise care for the Vines as required in accordance with good viticultural practice;
- supervise and inspect any Maintenance activities undertaken by subcontractors appointed by the Manager;
- manage soil quality;
- control weeds, pests, vermin, and diseases;
- maintain plant and equipment;
- maintain roads, fences, irrigation equipment, entryways, firebreaks, drainage and water catchment systems;
- undertake Marketing Services; and
- maintain insurance of the vineyard produce.

63. The Responsible Entity may engage contractors or others to perform its obligations under the Lease and Management Agreement. Under the Initial and Ongoing Services Agreement between the Responsible Entity and Palandri Project Management Pty Ltd (Manager), the Responsible Entity appoints the manager as an independent contractor to tend, maintain and harvest the Vines on the Land and to manage the Vineyard for the term of the Project.

64. The Responsible Entity will obtain insurance against public risk and on behalf of Growers obtain insurance of the Growers' Produce. If requested by a Grower, the Responsible Entity will also obtain, at the Grower's cost, insurance of the Vines on the Grower's Vineyard Lot(s).

Operational Management Agreement

65. The Operational Management Agreement is between Palandri Wines Ltd as the Responsible Entity and Palandri Investment Management Ltd as Operational Manager. The agreement appoints Palandri Investment Management Ltd to perform certain obligations of the Responsible Entity under the Lease and Management Agreement. The Operational Manager may delegate its responsibilities with the written consent of the Responsible Entity.

Pooling of grapes and entitlement to net proceeds

66. The Management Agreement sets out the provisions relating to the Grower's entitlement to harvest proceeds. The Responsible Entity will determine when there is a commercially harvestable crop and arrange for the grapes to be harvested. The vines are expected to reach full production in the fifth year after planting. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed grapes are entitled to benefit from distributions of harvest proceeds from the pool; and
- any pooled grapes must consist only of grapes contributed by Growers of the same Project class.

67. The proceeds from the sale of the Grower's grapes will be paid direct to the Responsible Entity who must deposit them into a Proceeds Fund. The Responsible Entity will pay out of the Grower's Proportional Interest, any outstanding fees or other amounts owing by the Grower, plus the costs of harvest and sale. The balance will then be distributed to the Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in the Constitution.

68. The net proceeds of grapes in excess of 12 tonnes per hectare in any one year will be shared in equal proportions between the Grower and the Responsible Entity.

69. If part of the Grower's Vineyard Lot is damaged or destroyed, the Proportional Interest of the Grower will be reduced as specified in clause 17 of the Lease and Management Agreement.

Fees

70. The fees payable under the Lease and Management Agreement per Vineyard Lot are as follows:

- Application Fee of \$3,960 payable to the Responsible Entity on application. This comprises a fee of \$2,557.50 for Initial Maintenance Services during the Initial Maintenance Period, Irrigation fee of \$412.50 and Ongoing Maintenance Services Fees for the Second and Third Maintenance Periods of \$990;
- Ongoing Maintenance Services Fees for the 2009-10 income year onwards equal to the sum incurred by the Responsible Entity plus 10%;
- rent of \$220 payable annually from the 2009-10 income year and increased by CPI each year. Rent for the Initial Maintenance Period is Nil and the rent for the Second and Third Maintenance Periods is paid in arrears out of harvest proceeds at the rate of 2% of Gross Harvest Proceeds over the life of the project;

- harvest and sale costs deducted from harvest proceeds; and
- optional insurance of Vines.

Finance

71. A Grower who does not pay the Application Fee in full upon application may borrow from Momentum.

72. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if the Grower enters into a finance arrangement with Momentum that materially differs from that set out in the documentation provided to the Tax Office with the application for the Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than Momentum may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

73. Growers cannot rely on any part of this Ruling if the Application Fee is not paid in full on or before 15 June 2007 by the Grower or, on the Grower's behalf, by Momentum.

Finance offered by Momentum

74. Subject to the terms and conditions of the Loan Agreement, a Grower can finance the cost of their Application Fee by borrowing that amount from Momentum under the following arrangements:

- 5 years Principal and Interest at an interest rate of 11%;
- 2 years Interest Only followed by 5 years Principal and Interest at an interest rate of 11%;
- 7 years Principal and Interest at an interest rate of 11%;
- 3 years Interest Only followed by 7 years Principal and Interest at an interest rate of 11.25%; and
- 10 years Principal and Interest at an interest rate of 11.25%.

75. The following conditions apply to the above loan arrangements:

- monthly payments of interest only or monthly repayments of principal and interest payable on the first Business Day of each month commencing on the first business day of the month following the loan drawdown date;
- application fee of \$250 plus 0.5% of the loan amount (may be added to the loan); and
- stamp duty, as applicable.

76. The interest rates mentioned at paragraph 74 of this Ruling are only indicative. The actual interest rate for the loans will be set by Momentum on the loan drawdown date.

77. The loans with Momentum are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a mortgage over the Grower's interest(s) in the Project.

78. This Ruling does not apply if the Momentum 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 Momentum; or
- Momentum does not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Commissioner of Taxation

23 May 2007

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?

79. For the amounts set out in paragraphs 25 and 26 of this Ruling to constitute allowable deductions, the Grower's viticulture activities as a participant in the Palandri Global Supply Challenge 2007-2008 must amount to the carrying on of a business of primary production.

80. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on a business of primary production.

81. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

82. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Palandri Global Supply Challenge 2007-2008. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

83. Having applied these principles to the arrangement set out above, a Grower in the Palandri Global Supply Challenge 2007-2008 is accepted to be carrying on a business of growing and harvesting grapes for sale.

The Simplified Tax System

Division 328

84. 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.

85. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). 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 Maintenance Services Fees, rent and interest on loans with Momentum**Section 8-1**

86. The Maintenance Services Fees and rent are deductible under section 8-1 (see paragraphs 43 and 44 of Taxation Ruling TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of Taxation Ruling TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Maintenance Services Fees or rent.

87. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Provided that the prepayment provisions do not apply (see paragraphs 90 and 97 of this Ruling) a deduction for these amounts may be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

88. Growers will finance their participation in the Project through a Loan Agreement with Momentum. Applying the same principles as that used for the Maintenance Services Fees and rent, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

89. Other than where the prepayment provisions apply (see paragraphs 90 to 97 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Prepayment provisions**Sections 82KZL to 82KZMF**

90. 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.

91. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 (operative provisions).

Application of the prepayment provisions to this Project

92. The expenditure incurred by a Grower in the Project for the Ongoing Maintenance Services Fees for the Second and Third Maintenance Periods meets the requirements of subsections 82KZME(1) and (2) of the ITAA 1936 and is incurred under an 'agreement' as described in subsection 82KZME(3) of the ITAA 1936. Therefore, unless one of the exceptions to section 82KZME of the ITAA 1936 applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF of the ITAA 1936.

93. If the prepaid Ongoing Maintenance Services Fees incurred by Growers in the initial year are less than \$1,000, those fees will be 'excluded expenditure' as defined in subsection 82KZL(1) of the ITAA 1936. Under Exception 3 (subsection 82KZME(7) of the ITAA 1936) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF of the ITAA 1936, and therefore is deductible in the year incurred. This applies to Growers who acquire one Vineyard Lot.

94. Growers who acquire more than one Vineyard Lot may incur prepaid Maintenance Services Fee exceeding \$1,000. Those Growers will need to calculate the deduction for each year using the formula in subsection 82KZMF(1) of the ITAA 1936. Section 82KZMF of the ITAA 1936 will apportion the deduction for prepaid Ongoing Maintenance Services Fees over the eligible service period which commences on 1 July 2007 and ends on 30 June 2009.

95. The Ongoing Maintenance Services Fees and rent from 1 July 2009 onwards are incurred annually and the interest payable to Momentum is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to these amounts.

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 fees or rent referred to in paragraph 95 of this Ruling or prepays interest under a loan agreement (including loan agreements with lenders other than Momentum). Where such a prepayment is made these 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, Growers who prepay fees or interest referred to in paragraph 95 of this Ruling are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

Expenditure of a capital nature***Division 40 and Division 328***

98. 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 and the establishment of the grapevines is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328.

99. 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'.

100. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 26 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***

101. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the 2006-07 to 2009-10 income years, based on the evidence supplied, the Commissioner has determined that for those income years:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35; and
- 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.

102. 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

103. 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

104. 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

105. 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).

106. The Palandri Global Supply Challenge 2007-2008 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 25 and 26 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.

107. 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 97/7, TR 97/11; TR 98/22;
TR 2000/8; TR 2002/6,
TR 2002/11; PR 2007/10

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
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