

***PR 2008/5 - Income tax: Margaret River Watershed
Premium Wine Project 2008 (Pre 15 June 2008
Growers)***



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Product Ruling

Income tax: Margaret River Watershed Premium Wine Project 2008 (Pre 15 June 2008 Growers)

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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 Margaret River Watershed Premium Wine Project 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 34 of this Ruling from 23 January 2008 and on or before 15 June 2008. They must 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 2008;
- participate in the scheme through offers made other than through the Product Disclosure Statement/Prospectus (PDS/Prospectus); or
- enter into finance arrangements with entities associated with this Project, other than those specified in paragraphs 71 to 78 of this Ruling.

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 34 to 79 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 January 2008, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 23 January 2008 until 15 June 2008, 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 2010. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

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 that extent, this Product Ruling will have no effect.

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 34 to 79 of this Ruling.

19. The Grower's participation in the Project must constitute the carrying on of 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 the Grower is granted a lease under the Lease and Sub-lease for 2008 Growers (Lease and Sub-lease) and at the time of execution of their Project Operations Agreement for 2008 Growers (Project Operations Agreement).

Concessions for 'small business entities'

20. From the 2007-08 income year, a range of concessions previously available under the simplified tax system (STS), will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

21. A 'small business entity' can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Because of these choices and the eligibility conditions the application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

Assessable income***Sections 6-5 and 17-5***

22. 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.

Deductions for Management Fees, Rent and interest**Section 8-1**

23. A Grower who is accepted to participate in the Project on or after 23 January 2008 and on or before 15 June 2008 may claim tax deductions, on a per Vinelot basis, for the following expenditure set out in the Table below.

Fee Type	Year ending 30 June 2008	Year ending 30 June 2009	Year ending 30 June 2010
Management Fees	See Notes (i), (ii) & (iv)	See Notes (i), (ii) & (iv)	See Notes (i), (ii) & (iv)
Rent	See Notes (i), (ii), (iii) & (iv)	\$407 (indexed) See Notes (i), (ii) & (iv)	\$407 (indexed) See Notes (i), (ii) & (iv)
Interest payable under the Terms Agreement in relation to Management Fees and Rent	As incurred See Notes (ii), (iv) & (v)	As incurred See Notes (ii), (iv) & (v)	As incurred See Notes (ii), (iv) & (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) Subject to Notes (iii) and (iv) the Management Fees, Rent and interest payable under the Terms Agreement for 2007 Terms Growers (Terms Agreement) are deductible under section 8-1 in the income year in which they are incurred. Part of the Management Fees for the years ended 30 June 2008 to 30 June 2010 will be used to acquire trading stock. The Responsible Entity has advised that \$786.35 of the \$4,400 Management Fees, during the year ended 30 June 2008, relates to the purchase of trading stock that will be on hand as at 30 June 2008 (refer to paragraphs 28 and 29 of this Ruling). The Responsible Entity will notify each Grower of the value of trading stock on hand at the end of each subsequent year of income.
- (iii) In the initial year, the deduction for Rent is \$34.92 per month for each month or part month that the Grower is granted the sub-lease to use the Vineyard. This means that the full \$419.10 rent payable in the year ending 30 June 2008 is not deductible in the 2008 Financial Year.

- (iv) This Ruling does not apply to Growers who choose to prepay fees or who choose, or are required to prepay interest under a loan agreement (see paragraphs 94 to 98 of this Ruling). 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 *Income Tax Assessment Act 1936* (ITAA 1936). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Watershed Premium Wines Ltd, in relation to the Terms Agreement, is outside the scope of this Ruling. Growers who enter into agreements with other financiers may request a private ruling on the deductibility of the interest incurred.

Deductions for capital expenditure

Division 40

24. A Grower who is accepted to participate in the Project on or after 23 January 2008 and on or before 15 June 2008 may claim tax deductions, on a per Vinelot basis, for the following expenditure set out in the Table below.

Fee Type	Year ended 30 June 2008	Year ended 30 June 2009	Year ended 30 June 2010
Application fee – Terms Agreement (Watershed Premium Wines Ltd)	\$20 See Notes (i) and (vi)	\$20 See Notes (i) and (vi)	\$20 See Notes (i) and (vi)
Establishment of the Grapevines	Nil See Note (vii)	Nil See Note (vii)	Nil See Note (vii)

Notes:

- (vi) The Terms Payment application fee payable to Watershed Premium Wines Ltd under the Terms Agreement is not deductible in full when it is incurred. Under section 40-880 it is deductible in equal proportions over five income years beginning in the year in which the Terms Payment application fee is incurred (see paragraphs 92 and 93 of this Ruling).

- (vii) A 'horticultural plant' is a 'depreciating asset' as defined in section 40-30 and vines 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. 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% per annum. The deduction is allowable when the Grapevines enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the Grapevines enter their first commercial season and the amount they can claim.

Shares in Watershed Land Ltd

Part 3-1

25. The shares in Watershed Land Ltd 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.

26. 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.

Subsection 44(1)

27. Any dividends paid out of profits by Watershed Land Ltd will be assessable income of the Grower under subsection 44(1) of the ITAA 1936.

Treatment of trading stock

Section 328-285

28. A Grower who is a 'small business entity' 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 can choose not to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

29. Where the small business entity chooses to account for changes in the value of their trading stock for an income year, they will have to do a stocktake and account for the change in the value of all their trading stock (Subdivision 70-C).

Section 70-35

30. A Grower who is not a 'small business entity' may, 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.

31. 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.

Division 35 – deferral of losses from non-commercial business activities**Section 35-55 – exercise of Commissioner's discretion**

32. A Grower who is an individual accepted into the Project on or after 23 January 2008 and on or before 15 June 2008 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ended **30 June 2008 to 30 June 2011**. 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.

Prepayment provisions and anti-avoidance provisions**Sections 82KZME, 82KZMF and 82KL and Part IVA**

33. For a Grower who commences participation in the Project and incurs expenditure as required by the Project Operations Agreement and the Lease and Sub-lease, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 94 to 98 of this Ruling);
- 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

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

- Application for a Product Ruling received on 24 October 2007 as constituted by documents and additional correspondence, including emails, received on 29 October 2007, 13 and 23 January 2008;
- **Product Disclosure Statement/Prospectus (PDS/Prospectus)**, of the Watershed Premium Wine Project 2008 received 24 October 2007;
- **Draft Project Operations Agreement for 2008 Growers** of the Watershed Premium Wine Project 2008 between Watershed Premium Wines Ltd (Responsible Entity) and the Grower received 24 October 2007;
- Standing Offer – Project Operations Agreement for Growers of the Watershed Premium Wine Project 2008, received 24 October 2007;
- **Draft Lease and Sub-lease for 2008 Growers** of the Watershed Premium Wine Project 2008, between Watershed Land Ltd (Land Owner) and Watershed Premium Wines Ltd (Responsible Entity) and the Grower received 24 October 2007;
- Standing Offer – Lease for Growers of the Watershed Premium Wine Project 2008, received 24 October 2007;
- **Draft Terms Agreement for 2008 Terms Growers** for the Watershed Premium Wine Project 2008 between Watershed Premium Wines Ltd (Responsible Entity) and the 2008 Terms Grower described in Item 1 of the Schedule, received 24 October 2007;
- Draft Compliance Plan for the Margaret River Watershed Premium Wine Project 2008 received 24 October 2007;
- Draft **Constitution** for the Margaret River Watershed Premium Wine Project 2008 received 24 October 2007;
- Option to Purchase Property dated 31 August 2007 between Watershed Land Ltd and Sissoev Pty Ltd (Owner) received 24 October 2007;
- Sub-Lease for Watershed Cellar Door Facility between Watershed Wines Ltd (Responsible Entity and Lessor), Watershed Marketing & Management Pty Ltd (Lessee) and Watershed Land Ltd (Owner), received 24 October 2007;

- Lease for Watershed Winery between Watershed Land Ltd (Owner) and Wines Ltd (Responsible Entity and Lessee), and
- Wine Production Agreement between Watershed Premium Wines Ltd (Responsible Entity), Watershed Wines Ltd (Winery) and the Custodian received 24 October 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.

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

36. 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

37. Following is a summary of the scheme:

Location	Sussex Locations 3114 & 3118, Boallia Road, Jindong
Type of business	A commercial viticulture and wine production business
The term of the Project	19 years
Size of each interest	0.05 hectare
Number of hectares offered for cultivation	Up to a maximum of 50 hectares
Number of Vines per hectare	1,640
Expected production	10 tonnes (720 cases) of Wine per hectare per year
Initial cost per interest	Application Rent Total fee \$4,400 + \$419.10 = \$4,819.10
Subscription for 160 Land Shares	\$520
Initial costs per hectare	\$96,382
Ongoing costs	Annual Management Fees, Rent and insurance costs

38. The Project is registered as a managed investment scheme under the *Corporations Act 2001*. Watershed Premium Wines Ltd has been issued with Australian Financial Service Licence No 296166 and will be the Responsible Entity for the Project.

39. The Project Land is situated in the South West Region of Western Australia, along Boallia Road in the Jindong region of the Margaret River wine region.

40. Growers applying under the PDS/Prospectus enter into a Lease and Sub-Lease with Watershed Land Ltd, to sub-lease to the Grower an identifiable area of the Project Land called a 'Vinelot'. Each Vinelot is 0.05 hectares in size.

41. The offer under the PDS/Prospectus is a stapled interest. 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 Vinelot. For each Vinelot applied for, an Applicant must also apply for 160 ordinary shares in the Land Owner, Watershed Land Ltd. The shares can be held by any entity and can be held in a different name from the Vinelot owner. Once the Responsible Entity has allotted a Vinelot to a Grower, the offer is no longer stapled and the shares can be transferred separately to the interest in the Vinelot. This Ruling only relates to shares held by Growers and does not address the tax consequences of disposing of shares in Watershed Land Ltd.

42. Applicants execute a Power of Attorney contained in the PDS/Prospectus. The Power of Attorney irrevocably appoints Watershed Premium Wines Ltd to enter into, on behalf of the Grower, a Lease, a Project Operations Agreement, the application for shares in Watershed Land Ltd and any other documents required to hold an interest in the Project.

43. The Project Operations Agreement appoints the Responsible Entity to develop and manage the Vinelots and Harvest the Grapes from the Vinelots. As required, the Responsible Entity will purchase Grapes and/or Wine to supplement the Grapes produced from the Vinelots. In addition, the Responsible Entity will arrange the Wine production, marketing, and sale of the Wine.

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

45. 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 2008. Growers who entered into the Project prior to the date of this Ruling may be covered by previous Product Rulings.

Constitution

46. The Constitution establishes the Project and operates as a deed binding on all Growers and Watershed Premium Wines Ltd. The Constitution sets out the terms and conditions under which Watershed Premium 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 (clause 3.4).

47. In order to acquire an interest in the Project, the Grower must make an application for a Vinelot in accordance with the PDS/Prospectus. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant and accompanied by the payment of the Application Money in a form acceptable to the Responsible Entity.

48. Watershed Premium Wines Ltd holds the Application Money on bare trust and will deposit all Application Moneys received from applicants in a Trust Account (clause 6).

49. Once Watershed Premium Wines Ltd has accepted the application and all of the Project Documents have been executed and remain in force, the Application Money may be applied against the fees due to Watershed Premium Wines Ltd (clause 3.6).

50. Under the Constitution, the Responsible Entity will keep a register of Growers. The Constitution also sets out provisions relating to:

- the Responsible Entity's powers (clause 6);
- delegation of powers (clauses 7 and 9);
- complaints handling (clause 13); and
- winding up the Project (clause 15).

Compliance Plan

51. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. Its purpose is to ensure that Watershed Premium Wines Ltd manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease and Sub-lease for 2008 Growers

52. Each Grower severally as Sub-lessee will execute a Lease and Sub-Lease with Watershed Land Ltd, as Land Owner and Sub-lessor, and Watershed Premium Wines Ltd, as Responsible Entity. Growers are granted an interest in the Vinelot in the form of a sub-lease to use their Vinelot for the term of the Project in return for the Rent (clause 2.1).

53. The Lease and Sub-Lease sets out the rights and obligations of the parties to the Agreement. Under the terms of the Lease and Sub-Lease each Grower will sub-lease a minimum of 1 Vinelot of 0.05 hectares. The Lease and Sub-Lease shall operate from the date the Vinelot is allotted to the Grower until 30 June 2026 (Part 4 of the Schedule).

54. Clause 4 provides that the improvements on the Land, including the Trellis, are the property of the Land Owner. At clause 2.3 the Land Owner grants the Grower the non-exclusive right to use:

- the irrigation for the purpose of cultivating the vines;
- the right to draw water from any dams on the Land or any other dam or water source for which the Land Owner has access; and
- all other infrastructure, plant and equipment available to, or owned by, the Land owner in or about the Land.

55. Under the Lease and Sub-Lease, Watershed Land Ltd 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).

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

57. The Lease and 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

58. Each Grower severally 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 (clause 2).

59. In return for the Management Fees set out in Part 2 of the Schedule, the Responsible Entity will carry out services in the Initial Period and the Ongoing Period as detailed in paragraphs 60 and 61 of this Ruling.

60. In the Initial Period being the period from the Commencement Date to 30 June 2008, the Responsible Entity will carry out the services set out in clause 5.4, which include:

- purchase an estimated 120 litres of red Wine as set out in Part 3 of the Schedule to the Agreement;
- produce and bottle an estimated six cases of white Wine as set out in Part 3 of the Schedule to the Agreement;

- maintain fences as exist on the Land to prevent the entry of kangaroos and vermin, soil degradation and protect the placements of Vines;
- keep a public risk insurance policy in respect of the Vineyard;
- maintain dams and water supply pumps and irrigation supplies, where applicable, to ensure the water supply is adequate at all times for Viticulture Farming; and
- carry out the brand and wine marketing strategy in accordance with the Sales & Marketing Plan and, where applicable, in accordance with Clause 11 of the Agreement.

61. In the Ongoing Period commencing on 1 July 2008, the Responsible Entity will carry out the services set out in clause 5.5, which may 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 (clause 9);
- 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;

- produce and bottle Wine as set out in Part 3 of the Schedule to the Agreement. Growers will be entitled to the actual quantity produced from their grapes, either grown on their Vinelots or acquired on their behalf; and
- keep the following insurance policies current with a reputable insurer:
 - a public risk insurance policy in respect of the Vineyard.; and
 - insurance on behalf of all 2008 Growers' Vinelots in relation to hail, fire, malicious damage, etcetera for Year 1 (1 July 2008 to 30 June 2009).

Pooling of Grapes and Wine and distribution of proceeds

62. 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 2008 (Pre 15 June 2008 Growers) on or after 23 January 2008 to on or before 15 June 2008.

63. 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 sub-lease in relation to total number of Vinelots sub-leased under the Project.

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

65. 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

66. Under the terms of the Lease and Sub-Lease and the Project Operations Agreement, a Grower will make payments as described below on a per Vinelot basis.

Application Money

67. Application Money of \$5,339.10, per Vinelot, is payable on application. The Application Money consists of:

- \$4,400 for Management Fees, for services to be performed during the period from the Commencement Date to 30 June 2008 (Part 2 of the Schedule to the Project Operations Agreement);
- \$409.10 for Rent (Part 5 of the Schedule to the Lease and Sub-lease); and
- \$520 for 160 fully paid Land Shares (PDS/Prospectus).

68. Upon signing the Application Form, the Grower acknowledges that the full amount of the Application Money is immediately due and payable. However, under the PDS/Prospectus, the Responsible Entity is offering a Terms Payment Option as described in paragraphs 74 to 78 of this Ruling.

Ongoing management fees

69. The following ongoing management fees are payable on or before 1 April in each relevant income year:

- \$4,466 payable on or before 1 April 2009, for services to be carried out in the period 1 July 2008 to 30 June 2009 (Part 2 of the Schedule to the Project Operations Agreement);
- \$4,785 payable on or before 1 April 2010, for services to be carried out in the period 1 July 2009 to 30 June 2010 (Part 2 of the Schedule to the Project Operations Agreement); and
- the Prescribed Portion of the actual costs, plus profit and any relevant insurance premiums for each income year commencing on 1 July 2010 to 30 June 2026, payable on or before 1 April in each relevant income year, commencing on 1 April 2011 (clause 4.3 of the Project Operations Agreement).

Ongoing Rent

70. Rent of \$419.10 (indexed) for each income year for the Project Term, commencing on 1 July 2008 and payable on or before 1 April each relevant income year, commencing on 1 April 2009 (Part 5 of the Schedule to the Sub-Lease).

Finance

71. A Grower who does not pay the Application Money in full upon application may enter into a Terms Agreement with Watershed Premium Wines Ltd or borrow from an independent lender external to the Project.

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 Watershed Premium Wines Ltd 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 may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

73. Other than where a Terms Agreement is in place Growers cannot rely on any part of this Ruling if the Application Money is not paid in full on or before 15 June 2008 by the Grower or, on the Grower's behalf, by a lending institution.

Terms Agreement

74. If a Grower chooses to pay the Application Money under the Terms Payment Option, they must complete a Terms Application Form, a Direct Debit Request and enter into a Terms Agreement with Watershed Premium Wines Ltd. Growers must pay a non-refundable application fee of \$100 per Vinelot applied for.

75. Under the Terms Payment Option a deposit of \$438.10 is payable on application with the balance payable by 12 equal monthly instalments of \$443.20 (including interest at 11.5% per annum daily reducing). The deposit will be applied to the GST on the Management Fees and Rent payable in the initial year.

76. The first monthly payment is due one month from the date of Allotment. The full amount of the Application Money must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

77. 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 Terms Agreement becomes immediately due and payable to the Responsible Entity. In addition, the Responsible Entity may take legal action to recover the balance of principal and interest and any costs payable under the Terms Agreement or any other legal action relating to the Terms Agreement, take possession of the Grower's Vinelot and do anything an owner of the secured property is entitled to do (clause 9.2 of the Terms Agreement).

78. Watershed Premium Wines Ltd may charge the Grower interest on overdue amounts (clause 2.6).

79. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than Watershed Premium Wines Ltd in relation to the Terms Agreement, are involved or become involved in the provision of finance to Growers for the Project.

Commissioner of Taxation

23 January 2008

Appendix 1 – Explanation

① *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?

80. For the amounts set out in paragraphs 23 and 24 of this Ruling to constitute allowable deductions, the Grower's horticulture and wine production activities as a participant in the Margaret River Watershed Premium Wine Project 2008 (Pre 15 June 2008 Growers) must amount to the carrying on of a business of viticulture and wine production. A proportion of these deductions will relate to carrying on a business of primary production.

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

82. 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?

83. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Margaret River Watershed Premium Wine Project 2008 (Pre 15 June 2008 Growers). 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.

84. Having applied these principles to the arrangement set out above, a Grower in the Margaret River Watershed Premium Wine Project 2008 (Pre 15 June 2008 Growers) is accepted to be carrying on a business of growing and harvesting grapes and production of wine for sale.

Deductibility of Management Fees, Rent and interest on the Terms Payment

85. Other than part of the Rent payable in the year ended 30 June 2008, the Management Fees and Rent are deductible under section 8-1 (see paragraphs 43 and 44 of 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, other than part of the Rent in the Initial Period, there is no capital component evident in the Management Fees and interest (see paragraphs 49 to 51 of TR 2000/8).

86. Subject to paragraphs 87 and 88 of this Ruling the tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

87. One of the exclusions under section 8-1 relates to expenditure that is capital, or is capital in nature. Any part of the expenditure of a Grower entering into a horticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that a portion of the Rent payable by a Grower will be capital expenditure.

88. A Grower who enters the Project on or before 15 June 2008 does not sub-lease the land for a full income year in the initial year. As there is no reduction in the Rent in the initial year to reflect the actual period of the sub-lease, it is considered that part of the Rent is a premium paid by the Grower for the grant of the sub-lease and is capital in nature. Therefore, under section 8-1 Growers will be entitled to a partial deduction of \$34.92 calculated on a pro-rata monthly basis for each month or part month that the Grower is granted the sub-lease to use the Vinelot from Watershed Land Ltd.

89. Subject to this qualification and provided that the prepayment provisions do not apply (see paragraphs 94 to 98 of this Ruling) a deduction for the Management Fees and Rent can be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

90. Some Growers may finance their participation in the Project through a Terms Agreement with Watershed Premium Wines Ltd. Applying the same principles as that used for the Management Fees and Rent, interest incurred under the Terms Agreement in interest payable under the Terms Agreement in relation to the Management Fees and Rent has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

91. Other than where the prepayment provisions apply (see paragraphs 94 to 98 of this Ruling), a Grower can claim a deduction for interest in relation to the Management Fees and Rent in the year in which it is incurred.

Application Fee payable under a Terms Payment Agreement

Section 40-880

92. Growers who elect to pay their Grower's contribution under the Terms Payment Agreement must pay a non-refundable application fee of \$100 per Vinelot. This expenditure does not constitute a borrowing expense and is therefore not deductible under section 25-25. As it is capital in nature it is also not deductible under section 8-1.

93. However, section 40-880 will allow the Application Fee to be deducted in equal proportions over five income years starting in the year in which the Grower incurred the amount (subsection 40-880(2)). Section 40-880 applies to capital expenditure that is incurred in relation to a business and which is not taken into account elsewhere or denied deductibility under another provision of income tax law.

Prepayment provisions

Sections 82KZL to 82KZMF

94. 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.

95. 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

96. Under the Scheme to which this Product Ruling applies the Management Fees and Rent are incurred annually and the interest payable to Watershed Premium Wines Ltd is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Scheme.

97. 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 Lease and Sub-lease, or prepays interest under a loan agreement (including loan agreements with lenders other than Watershed Premium Wines Ltd in relation to the Terms Agreement). Where such a prepayment is made these prepayment provisions will also apply to small business entities because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

98. As noted in the Ruling section above, Growers who prepay fees or interest referred to in paragraph 23 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

99. 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.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – exercise of Commissioner’s discretion***

100. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year ending **30 June 2008 to 30 June 2011**, 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 truffle farming industry, a Grower’s business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

101. 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.

102. 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

103. 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

104. 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).

105. The Margaret River Watershed Premium Wine Project 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 23 and 24 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.

106. 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 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.

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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; PR 2007/36;
PR 2007/95

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- horticulture
- 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:

- ITAA 1936 44(1)
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZLA
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
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- ITAA 1936 177A
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