

PR 2001/173 - Income tax: Brookhampton Estate Vineyard Project

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Product Ruling

Income tax: Brookhampton Estate Vineyard Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

Potential participants may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

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

Potential participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the SIPR NCL discretion project, or simply as 'the Project'.

Tax laws

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a 'Grower') to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that

promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is those persons who were accepted into the project between 5 June 1998 and 18 May 1999. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 19 December 2001 for Growers who, between 5 June 1998 and 18 May 1999, entered into the specified arrangement that is set out below. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling

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has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, even following its withdrawal, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement that is set out below between 5 June 1998 and 18 May 1999. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Brookhampton Estate Vineyard Prospectus dated 5 June 1998;
- **Lease and Management Agreement between Brookhampton Estate Vineyard Management Ltd ('the Manager'), Charters Securities Pty Ltd ('the Trustee'), Brookhampton Estate Pty Ltd ('the Lessor') and the Grower;**
- **Vineyard Development Agreement between the Manager, the Trustee, the Lessor and the Grower;**
- Share Subscription Agreement dated 3 June 1998 between the Manager and the Brookhampton Estate Investments Limited, ('the Investment Company');
- **Loan Agreement between the Manager and the Grower;**
- Product Ruling application received 22 February 1999; and
- additional correspondence from the Applicant dated 8 March 1999, 1 April 1999, 8 April 1999, 13 April 1999, 21 April 1999, 27 April 1999, 7 May 1999, 10 May 1999, 11 May 1999, 22 August 2001 and 20 November 2001.

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

15. The documents highlighted are those that Growers entered or may have entered into. For the purposes of describing the arrangement 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 the Grower, will be a party to. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called 'The Brookhampton Estate Vineyard Project'. Growers who entered into the arrangement obtained an Interest in a Leased Area, ready for planting, to grow vines on land in the vicinity of Donnybrook, Western Australia for a period of 13 years. Growers obtained an Interest in a 0.2 hectare lot planted with approximately 250 vines. The vineyard development has commenced.

17. Growers were also able to subscribe for 1,500 shares in the Investment Company, which in turn was entitled to subscribe for up to 40.9% of the shares in the Lessor.

18. Overall it was proposed to plant 120 hectares, which comprises 600 Interests. These Interests are separately identified in the Vineyard Development Plan. There was no minimum subscription for the Project to proceed. The Manager anticipated that the vineyard would come into production in year 2 of the Project and that it would be in full production by year 6.

19. The Growers entered into a contract with the Manager for the purchase and establishment of vines (cuttings), the purchase and establishment of an irrigation system and the purchase and establishment of trellising on their Leased Area.

20. The Growers also entered into a separate contract for the lease and management of their vineyard. Growers have an option to take possession of their grapes after harvest and be responsible for processing and marketing the grapes themselves. Where a Grower does not make this election, the Manager, on behalf of the Grower, will market and sell the grape produce.

Vineyard Development Agreement

21. The Agreement is made between the Grower, the Manager, the Trustee and the Lessor.

22. The Grower agreed to engage the Manager to perform all the works required to establish the vineyard on the prepared land. This included establishing:

- and planting the grape cuttings on the land;
- a trickle irrigation system to the vines; and
- a suitable trellising system to support the vines.

23. In consideration for these services, the Grower agreed to pay a fee to the Manager. This fee was payable out of the application money paid by the Grower under the terms of the Prospectus.

24. The Grower owns the vines and equipment that the Manager installed on the Grower's Leased Area(s) as part of the works. Upon completion of the Project, ownership of these assets will pass to the Lessor as owner of the land.

25. The Manager reserves the right to delegate or subcontract any of its duties to be performed under the Agreement.

Lease and Management Agreement

26. Growers make payments for rent and management fees under the Lease and Management Agreement.

27. The Grower leases from the Lessor a Leased Area (as defined in clause 2.1 to the Agreement). Some of the conditions of the lease are that the Grower:

- will not permit the use of the Leased Area for a purpose other than the Project;
- will at all times manage the Leased Area in a proper and skilful manner and in accordance with approved viticultural practices; and
- will not use, or permit any other person to use the Leased Area for residential, recreational or tourist purposes.

28. In return, the Grower has the right to peaceably possess and enjoy the Leased Area and the Grower at all times has full right, title and interest in the grapes produced from the Leased Area.

29. At the expiration, or sooner termination (triggered by a breach of the Agreement by the Grower which is not remedied) of the term of the Lease and Management Agreement, the Grower will surrender and yield the Leased Area and fixtures in good repair, order and condition.

30. The Grower has appointed the Manager to maintain, supervise and manage on a day to day basis, on behalf of the Grower, all activities carried on by the Grower on their Leased Area. The

Manager is required to perform these services in a proper and skilful commercial manner, and in accordance with good viticultural practices. The Manager will harvest the grape crop or arrange for some other person to harvest the grapes. The Manager will also arrange public risk insurance in respect of the vineyard and insure the vines on the Leased Area in respect of various events of destruction, if this is the practice in the region and if it is commercially viable.

31. Unless the Growers have elected otherwise, the Lease and Management Agreement authorises the Manager to market and sell the grapes of their Leased Area(s) as agent of the Growers.

Fees

32. The Growers were required to make the following payments per Leased Area for the first year of the Project:

- a management fee of \$6,625 to the Manager, for the management of the vineyard for the period from the execution of the agreement until 30 June 1999;
- a lease fee of \$270 for the Growers' use of the land, payable to the Lessor for the period to 30 June 1999;
- a fee of \$65, payable to the Manager, being a first instalment for the purchase and establishment of grapevine cuttings;
- a fee of \$930, payable to the Manager; for establishment and installation of the irrigation system; and
- a fee of \$810 payable to the Manager to supply and construct a trellising system.

33. The Growers were required to make the following payments per Leased Area for the second and third year of the Project:

- a management fee of \$2,400 payable to the Manager for management of the vineyard for the year ended 30 June 2000, \$1,800 for the year ended 30 June 2001;
- a lease fee of \$270 payable to the Lessor for the year ended 30 June 2000 and another payment of \$270 for the year ended 30 June 2001; and
- the second and final instalment of the purchase price for the vines of \$190, payable to the Manager.

34. The Growers will make the following payments per Leased Area in subsequent years until completion of the 13 year Project period:

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- a payment of \$1,800 for the year ended 30 June 2002. From then on, the management fee will be indexed at 3% per annum; and
- from the third year of the Project, the lease payments will increase at the rate of 3% per annum.

35. If Growers took up the option of purchasing shares in the Investment Company, they paid \$1,500 for 1,500 fully paid up shares at \$1.00 each.

Finance

36. Growers could fund their involvement in the Project by borrowing from the Manager.

37. Those Growers were able to enter into the following finance arrangement:

- Finance to the Growers from the Manager was to be on normal commercial terms;
- Finance packages offered by the Manager were limited to a total of \$650,000 and were to be provided on a full recourse basis;
- borrowers paid a 25% deposit on application;
- the balance repayable over 3 or 5 years at a daily interest rate of 9.5% or 10.5% per annum respectively;
- borrowers make monthly repayments of principal and interest;
- borrowers paid a non-refundable application fee of \$300;
- Finance offered on a full recourse basis and the loan was secured by a mortgage over a Grower's interest in the Project and any shares held by the Grower in the Investment Company;
- The borrower's obligation to pay the Manager interest and repay the loan is absolute and it is not subject to any condition regarding the state of the Project, availability of crop proceeds, etc. In addition, if the borrower defaults on the loan, all of the secured monies (all amounts now or at any time in the future owing comprising the Principal sum, all interest and all other fees owing under the loan) immediately become payable. Legal action will be taken to recover any outstanding payments;

- Personal guarantees from Directors of corporate borrowers were required;
- The Manager was to fund this finance to the Growers from a loan facility it has established with a major bank. The Applicant has advised that this loan facility was restricted to a maximum of \$650,000. Some features of this loan facility are that:
 - the bank required the Manager to deposit with it funds to the extent of 50% of any outstanding loan balance as security under the agreement; and
 - no term deposit/cash security was to be released by the bank until the term deposit/cash security is equal to 100% of the debt outstanding.

38. 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 or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than Manager are involved or become involved in the provision of finance to Growers for the Project.

Ruling

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

Section 35-55 – Commissioner’s discretion

39. For a Grower who is an individual and who entered the Project between 5 June 1998 and 18 May 1999 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income year ended 30 June 2001 that the rule in section 35-10 does not apply to this business activity. This is provided that the Project has been, and continues during the remainder of the term of the Project to be, carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 14 to 38 of this Product Ruling.

40. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 46 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

41. Where, the exception in subsection 35-10(4) applies, the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

42. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An

assessment of the Project or the product from this perspective has not been made.

Explanations

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

43. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

44. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

45. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

46. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

47. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

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- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

48. A Grower who was accepted into and who has participated in the Project between 5 June 1998 and 18 May 1999 is carrying on a business activity that is subject to these provisions.

49. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired the minimum allocation of one interest(s) in the Project is unlikely to have their business activity pass one of the tests until the income year ended 30 June 2004. Growers who acquired more than one interest(s) in the Project may however, find that their activity meets one of the tests in an earlier income year.

50. Prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

51. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

52. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of one interest(s) in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2002. The Commissioner has decided for such a Grower that it would be reasonable to exercise the second arm of the discretion

until the year ended 30 June 2001. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2001.

53. The applicant has stated that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs **Error! Reference source not found.** to 38 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 39), in the manner described in the arrangement, this Ruling may be affected. Specifically, the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

54. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report of the independent viticulturist and additional expert or scientific evidence provided with the application by the Manager;
- independent, objective, and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application; and
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Detailed contents list

55. Below is a detailed contents list for this Product Ruling:

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Commissioner of Taxation

19 December 2001

Previous draft:

Not previously issued in draft form

*Legislative references:**Related Rulings/Determinations:*

PR 1999/95; TR 92/1; TR 97/11;
TR 97/16; TR 92/20; TR 98/22;
TD 93/34

Subject references:

- carrying on a business
- commencement of a business
- management fees
- primary production
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- viticultural expenses

- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1936 82KL
- ITAA 1936 Pt IVA

ATO references:

NO: T2001/019422
ISSN: 1441-1172