

# ***PR 2002/37 - Income tax: Wrights Bay Vineyard Stage 3***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *10 April 2002*



# Product Ruling

## Income tax: Wrights Bay Vineyard Stage 3

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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**

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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 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. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

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.

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## **What this Product Ruling is about**

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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 Wrights Bay Vineyard Stage 3, or simply as 'the Project'.

### **Tax law(s)**

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 29 June 2001 and 4 January 2002. 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**

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11. This Ruling applies prospectively from 10 April 2002 for Growers who, between 29 June 2001 and 4 January 2002, 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 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**

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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 29 June 2001 and 4 January 2002. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## **Arrangement**

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

- Application for a ruling from Wrights Bay Vineyard Pty Limited ("WBVPL") dated 20 September 2001;
- Wrights Bay Vineyard Information Memorandum;
- **Sale of Land contract between WBVPL and the Grower, which includes additional clauses covering:**
  - (a) **community corporation bylaws;**
  - (b) **the development of the vineyard;**
  - (c) **management and operations of the vineyard;**
  - (d) **grape purchase; and**
- Grape Sale and Purchase Agreement with Kingston Estate Wines (Australia) P/L ("Kingston Estate").

**Note: certain information received from WBVPL 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 the Growers entered into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, was or is a party to.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

**Overview**

17. The arrangement is called Wrights Bay Vineyard Stage 3.

Location	Mount Benson in southeastern South Australia. 20 kilometres north of Robe, 320 km south of Adelaide
Type of business each participant is carrying on	Viticulture
Product name description	Wright's Bay Vineyard Stage 3
Number of lots sold	3
Minimum subscription	Not applicable
Size of each purchased area	3.28 hectares
Number of vines per hectare	1,830
Expected production	The first harvest from stage 3 will be in 2004.
The term of investment in years	Growers have freehold title over their land and have an associated management agreement expiring in 2012
Initial Cost	\$116,497
Initial cost per hectare	\$35,517
Ongoing costs	Management fees
Grape Sale Contracts	Sales contracts for 100% grapes produced confirmed until 2012

**Description**

18. A Grower in the project bought freehold title to 3.28 hectares of land, which is subject to Community title. The land had already been prepared for the establishment of a vineyard with the land having been ripped, rocks crushed and removed, the land re-levelled and marked out for planting. Under the terms of the Community Corporation by-laws the land may only be used for viticulture, and no dwelling or improvements other than the vineyard infrastructure are permitted.

19. The Community title associated with the vineyard is governed by the *South Australian Community Titles Act 1996*. Under this Act the owner of a Community lot owns all of the improvements on that lot and the common property is vested in the owners of the Community lots as tenants in common. Common assets and infrastructure include windbreaks, roads, bores, parking lot, gates, multi purpose shed comprising lock up storage areas, workshop and

vehicle bays, amenities room/managers office and shower and toilet facilities, lock up chemical storage/collection/loading facility, and power connected to the shed.

### **Sale of Land Contract**

20. The Sale of Land contract between WBVPL and the Grower includes clauses which cover the community corporation by-laws, the development of the vineyard, the management and operation of the vineyard and the purchase of the grapes. These rights expire on 30 June 2012.

21. Growers are required to contribute to the indirect expenses of the Community Corporation, which include the purchase of fuel for the pumps, rates and insurance in respect of common land and assets. Growers may also be required to contribute to a sinking fund established by the Community Corporation for the long term maintenance or development of the community assets

22. Growers are required to reimburse WBVPL for the mains irrigation system (clause 4). This system is designed to supply water from the bores to each lot.

23. Growers contracted with WBVPL for the supply and installation of trellising, vines and a sub irrigation system for each lot (clause 5). WBVPL engaged local contractors to carry out these functions. Each lot contains approximately 6,000 vines. These were grafted rootstock and are one or more of the following grape varieties: shiraz, chardonnay, and sauvignon blanc.

### **Management Services**

24. Growers also contracted with WBVPL to provide ongoing management of the vineyard for a period ending 30 June 2012 (clause 6). Thereafter the growers may make other arrangements. The ongoing management duties include:

- Monitoring and nurturing of the vines;
- Pruning and tying the vines;
- Irrigating and fertilising the vines;
- Spraying the vines with pesticides, herbicides and fungicides as necessary;
- Establishing and maintaining cover crops;
- Harvesting the grapes; and
- Maintaining the assets of the vineyard.

**Grape Sale and Purchase Agreement**

25. WBVPL has entered into a Grape Sale and Purchase Agreement with Kingston Estate. This agreement provides for the purchase by Kingston Estate of all the fruit produced by the vineyard up until 30 June 2012. The price to be paid for the fruit is equal to the weighted average “grape price per tonne at farmgate” plus or minus a bonus or penalty for quality, for each variety as published by the relevant authority, for the “Limestone Coast – Other” Region.

26. WBVPL will contract with each Grower to purchase all the fruit from each lot on essentially the same terms. Under this arrangement the fruit from each lot will be pooled and on sold to Kingston Estate. The price paid to the Growers will be the price received from Kingston Estate less associated costs such as insurance, cartage and an administration fee of 1% of the net proceeds.

27. It is envisaged that grapes will be harvested and sold during the third growing season. The fruit from Stage 3 is to be kept separate till 2006 when it will be pooled with the fruit from Stages 1 and 2. Sale proceeds are payable two-thirds prior to 30 June and one-third post 30 June of each year.

**Fees payable by a Grower**

28. The growers will make the following payments for the first three years of operations.

29. Payments for each 3.28 hectare lot in stage 3:

<b>Description</b>	<b>Amount</b>
<b>Payments to acquire and develop a 3.28 hectare lot</b>	
Freehold Land *	27,060
Irrigation systems	29,753
Supply and installation of Trellising	32,111
Supply and planting of Rootstock	27,570
<b>Total</b>	<b>116,494</b>
<b>First Growing Season</b>	
Management & Operations	24,750
Indirect Expenses	1,804
<b>Second Growing Season</b>	
Management & Operations	31,790
Indirect Expenses	1,804

<b>Third Growing Season</b>	
Management & Operations	21,604
Indirect Expenses	1,804

\* Includes infrastructure and land preparation

30. Payments are required to be made in subsequent years for the ongoing management and operation of the vineyard, and for the Community Corporation expenses. Fees are based on the third growing season fees increased annually by the greater of CPI increases or increases in input costs over the preceding year, if any.

### **Finance**

31. Growers funded their involvement in the Project themselves, or borrowed from an independent lender.

32. 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 are involved or become involved in the provision of finance to Growers for the Project.

## **Ruling**

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

#### **Section 35-55 – Commissioner’s discretion**

33. For a Grower who is an individual and who entered the Project between between 29 June 2001 and 4 January 2002 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 years ended 30 June 2001 to 30 June 2004 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 32 of this Product Ruling.

34. 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 40 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)).

35. 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.

36. 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**

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

37. 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.

38. 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.

39. 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.

40. For the purposes of applying the 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.

41. In broad terms, the tests require:

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

42. A Grower who was accepted into the Project between 29 June 2001 and 4 January 2002 and who has participated in the Project since the date of his/her acceptance, is carrying on a business activity that is subject to these provisions.

43. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired the minimum allocation of 1 interest in the Project is unlikely to have their business activity pass one of the tests until the income year ended 30 June 2005. Growers who acquired more than 1 interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

44. 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.

45. 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;
- (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.

46. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of 1 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 2005. 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 2004.

47. 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 14 to 32 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 33), 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.

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

- the report of the independent viticulturist;
- the binding contract with Kingston Estate Wines (Australia) P/L for the sale of the grapes setting out prices that realistically reflect the existing market and the projected market in the geographical region where the grapes are grown; and
- 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 submitted by the Responsible Entity.

## **Detailed contents list**

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## **Commissioner of Taxation**

10 April 2002

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<i>Previous draft:</i>	- ITAA 1997 35-10(2)
Not previously released in draft form	- ITAA 1997 35-10(3)
	- ITAA 1997 35-10(4)
	- ITAA 1997 35-30
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-35
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1997 35-40
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 35-45
TD 93/34;	- ITAA 1997 35-55
<i>Subject references:</i>	- ITAA 1997 35-55(1)
- management fees	- ITAA 1997 35-55(1)(a)
- primary production	- ITAA 1997 35-55(1)(b)
- primary production expenses	- ITAA 1997 35-55(2)
- producing assessable income	- ITAA 1936 82KL
- product rulings	- ITAA 1936 Pt IVA
- public rulings	- TAA 1953 Pt IVAAA
	- Copyright Act 1968
	- South Australia Community Titles Act 1996
<i>Legislative references:</i>	
- ITAA 1997 Div 35	
- ITAA 1997 35-10	

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ATO references:

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