

# ***PR 2002/58 - Income tax: Frankland Valley Vineyard Project No. 2***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 May 2002*



## Product Ruling

### Income tax: Frankland Valley Vineyard Project No. 2.

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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**

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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**

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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

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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 Frankland Valley Vineyard Project No. 2, 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 3 March 1998 and 3 March 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. Nor does the Ruling apply to Growers who elect to collect and market the grape produce for the leased area personally. They may seek a private ruling on the tax consequences of such action. Those Growers not exercising this election are referred to as 'non-electing Growers'.

**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 8 May 2002 for Growers who, between 3 March 1998 and 3 March 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 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 2003. 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 3 March 1998 to 3 March 1999. 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:

- Frankland Valley Vineyard Project No.2 Prospectus dated 3 March 1998;
- Supplementary prospectus dated 17 June 1998;
- **Trust deed dated 19 January 1998 between Frankland Valley Co Ltd ('Manager'), Charters Securities Pty Ltd ('Trustee') and Ferngrove Vineyards Ltd ('Lessor');**
- **Frankland Valley Vineyard Project No.2 constitution dated 24 January 2000;**
- **Lessor's memorandum and articles of associations;**
- Placement and Underwriting agreement between Smith Coffey Securities Pty Ltd ('Underwriter'), Ferngrove Vineyards Limited ('Company') and Frankland Valley Co Ltd ('Manager') dated 17 September 1998;
- **Lease agreement between Ferngrove Vineyards Pty Ltd ('Lessor') and Frankland Valley Co Ltd ('Lessee'), undated;**

- Newsletter of Frankland Valley Company Ltd dated, Autumn 2000, Spring 2000, Summer 2000, Winter 2001;
- Report on Frankland Valley Vineyard Project No 2 prepared by Peter Gherardi dated 27 August 1999;
- Application for Product Ruling dated 13 September 2001; and
- Correspondence with the applicant dated 11 October 2001 and 24 October 2001, 30 January 2002 and 27 March 2002.

**Note: certain information received from Frankland Valley Vineyard Project No. 2 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 salient features and effect of these arrangements are summarised below:

Location	13 kilometres West of the town of Frankland in the Great Southern region of Western Australia.
Type of business each participant is carrying on.	Commercial growing and harvesting of grapevines for the sale of grape produce.
Number of hectares offered for cultivation.	150 hectares.
Possible total subscription	750 Leased Areas and 2,439,000 shares in the Lessor.
Size of each leased area	0.2 hectares.
Minimum allocation	1 Leased area and subscribe in the Lessor at an issue price of \$1 per share.
Number of vines established per	308 vines per 0.2 of hectare, therefore 1540 per hectare.

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hectare	
Expected Production	Full yield of 11 tonnes per hectare from year five.
The term of the project	14 years.
Initial cost	\$15 462 for initial 13 month establishment period.
On-going costs	Annual Management Fee; Rent; Annual insurance premiums; Cost of harvesting produce, however members can undertake their own harvesting and marketing if they elect to do so.

18. The prospectus invited Growers to participate in two specific interests. The first was the right to participate in a project called Frankland Valley Vineyard Project No. 2. The second was a right to purchase shares in the Lessor, an unlisted public company.

19. A Supplementary Prospectus was issued on 17 June 1998 which provided for a future payment of \$3,600 to be made by the Manager to each Grower in the event that certain projected grape yields over the period 1 July 2002 to 30 June 2004 were not met.

20. The project involves the planting of grapevines upon land that is held by the Lessor. The project is for a period of 14 years.

21. A Lease and Management Agreement was entered into between Frankland Valley Co Ltd, Ferngrove Vineyards Ltd and the Grower. This Agreement is set out in the Second Schedule to the Constitution. The Agreement provides for the lease of a property known as "Ferngrove" located at Portion of Nelson Location 345 being lots 3 and 22 on Plan 22229 and being the whole of the land comprised in Certificates of Title Volume 2127 Folio 927 and Volume 2127 Folio 930.

22. Under the Lease and Management Agreement, each Grower has acquired a leasehold interest in an identifiable area of land comprising 0.2 hectares (one Leased Area). The Grower has an interest in the vines and full title to the grapes produced from the leased area, from the time of plantation to the expiration of the Lease and Management Agreement. On expiry of the 14 year Lease and Management Agreement, the vineyard will be owned in its entirety by the Lessor. Growers who have acquired shares in the Lessor will then hold an indirect interest in the vineyard.

**Shares in Ferngrove Vineyards Limited**

23. Under the project, a Grower purchases a minimum of 3,252 shares in the company Ferngrove Vineyards Limited, at an issue price of \$1 per share. The prospectus offered 750 parcels of 3,252 shares, representing 81 per cent of the project. The remaining 19 per cent will be purchased by the promoters.

24. The lessor will also operate a grape processing facility. Profits generated from the facility will be paid to Shareholders in the form of dividends.

**Lease and Management Agreement**

25. The Lease and Management Agreement sets out the roles and obligations of the parties to the agreement. The agreement is entered into between Frankland Valley Co Ltd, Ferngrove Vineyards Ltd and The Grower.

26. The agreement regulates:

- the lease of the leased area;
- establishment and management of the vineyard on the leased area;
- harvesting and marketing of grape produce;
- distribution of the annual proceeds from the sale of the grape produce.

27. Under the terms of the agreement the Grower may only use the land for the purpose of commercial viticulture and the Project. The Lessor grants a lease to the Grower and the Grower appoints the Responsible Entity to plan, develop, manage and maintain the vines on the Leased Area and be responsible for the harvesting, marketing and sale of the grape produce from the Leased area.

28. The Manager is primarily responsible for establishing and managing the vineyard until the completion of the year 2011/2012.

**Trust Deed**

29. The Trust Deed regulates

- the raising and application of the subscription moneys payable by way of establishment fees;
- the establishment of the project and the vineyard;
- the scope of the Manager's and trustee's obligations;

- payment of the establishment fees and management fees to the trustee and the disbursement of those fees to the Manager;
- the Trustee's reserve fund; and
- the administration of the project, including accounts and audit, meetings of growers, the register of growers and the assignment of transfer of interest in the leased areas.

## Fees

30. A Grower entering into the Frankland Valley Vineyard Project No. 2 was liable for the following amounts:

- **Initial costs** of the Management Fees of \$9,000, payment of \$450 for rootlings/cuttings, irrigation costs of \$1,050, trellising costs of \$1,425 and the initial rent of \$285, payable on application (total of \$12,210);  
The cost of subscribing for shares in the Lessor, payable on application. The parcel of shares is 3,252 per leased area, at a price of \$1 per share, giving a minimum outlay of \$3,252;
- **Ongoing costs** of rent of \$285 and Management Fees of \$1,700 in respect of the period ending 30 June 1999, payable on or before 30 June 1999;  
Rent of \$285 and Management Fees of \$1,500 in respect of the period ending 30 June 2000, payable on or before 30 June 2000;  
Thereafter, Rent and Management Fees (indexed for inflation), payable on or before 30 June each year in respect of the period ending 30 June;
- **Insurance** where growers insure their vinelots, premiums for insurance against damage to the vinelots (if any) will be payable;
- **Finance costs** if money is borrowed to fund Project expenditure, interest costs may be incurred; and
- **GST** will be payable as required by the manager. All of the above expenditure is exclusive of GST.

## Harvesting

31. For the term of the agreement, the Grower will have full right title and interest in the grape produce from the leased area and the

right to have the grape produce from the leased area sold for their benefit. Unless the Grower elects to take possession of their harvested grape produce, the Responsible Entity will arrange the marketing and the sale of the grape produce.

32. Grapes will be harvested, marketed and sold on a collective basis. Harvests will be pooled and the proceeds shared by the Growers on a pro rata basis.

### **Finance**

33. Growers are entitled to fund their participation in the Project themselves, borrow from the Bank of Western Australia Ltd (a lender who has agreed to lend up to 100% of the initial fees of \$12,210 per leased area) or borrow from an independent lender.

34. 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**

35. For a non-electing Grower who is an individual and who entered the Project between 3 March 1998 to 3 March 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 years ended 30 June 2001 to 30 June 2002 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 34 of this Product Ruling.

36. 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 42 in the Explanations part of this ruling, below);
- a non-electing Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the non-electing 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)).

37. Where, the ‘exception’ in subsection 35-10(4) applies, the non-electing 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 non-electing 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.

38. Non-electing Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, non-electing 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**

39. 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.

40. 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.

41. 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.

42. 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.

43. 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

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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).

44. A non-electing Grower who was accepted into and who has participated in the Project since 3 March 1998 to 3 March 1999 is carrying on a business activity that is subject to these provisions.

45. Information provided with the application for this Product Ruling and additional information provided since, indicates that a non-electing Grower who acquired the minimum allocation of 0.2 hectares interest in the Project is unlikely to have their business activity pass one of the tests until the income year ended 30 June 2003. Non-electing Growers who acquired more than 0.2 hectares interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

46. 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 non-electing Growers participation in the Project.

47. 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 nor will it meet 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.

48. The information provided by the applicant indicates that a non-electing Grower who acquired the minimum allocation of 0.2 hectares interest 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 2003. The Commissioner has decided for such a non-electing Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2002.

49. The applicant has stated that the business activity comprised by a non-electing Growers 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 34 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 35), 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.

50. 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 Responsible Entity;
- Product Ruling PR 2001/30.

## **Detailed contents list**

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

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**Commissioner of Taxation**

8 May 2002

	- agricultural expenses
<i>Previous draft:</i>	
Not previously released in draft form	<i>Legislative references:</i>
	- ITAA 1997 Div 35
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-10
PR 1999/95; PR 2001/30; TR 92/1;	- ITAA 1997 35-10(2)
TR 92/20; TR 97/16; TD 93/34;	- ITAA 1997 35-10(3)
TR 98/22	- ITAA 1997 35-10(4)
	- ITAA 1997 35-30
<i>Subject references:</i>	- ITAA 1997 35-35
- carrying on a business	- ITAA 1997 35-40
- commencement of a business	- ITAA 1997 35-45
- management fees	- ITAA 1997 35-55
- non commercial losses	- ITAA 1997 35-55(1)
- primary production	- ITAA 1997 35-55(1)(a)
- producing assessable income	- ITAA 1997 35-55(1)(b)
- product rulings	- TAA 1953 Pt IVA
- public rulings	- Copyright Act 1968
- schemes	
- tax avoidance	
- tax benefits	

ATO references:

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ISSN: 1441 1172