



# ***PR 2001/105 - Income tax: Norfolk Ridge Vineyards***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *27 June 2001*



# Product Ruling

## Income tax: Norfolk Ridge Vineyards

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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 investors 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 as an investment. 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 investors 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 the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors 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, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors 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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' 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 Norfolk Ridge Vineyards, or simply as 'the Project'.

### Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- 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.

### Business Tax Reform

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 laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who have invested 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 investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should

minimise suggestions that investors have been negligently or otherwise misled.

### **Class of persons**

7. The class of persons to whom this Ruling applies is those who entered into the arrangement described below from 12 May 1998 until the issue of Product Ruling PR 1999/18 on 5 May 1999. They have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. 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 intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 42) is carried out in accordance with details described 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 as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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## Date of effect

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12. This Ruling applies prospectively from 12 May 1998. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a taxation dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, 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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14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who entered into the specified arrangement on or after 12 May 1998 during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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15. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- **Norfolk Ridge Prospectus dated 12 May 1998 prepared and issued by Norfolk Ridge Vineyards Ltd (formerly Egerton Vineyard Management Ltd) as Trustee for the EVM Unit Trust (“the Manager”) and Norfolk Ridge Ltd (formerly Egerton Vineyards Mt Barker Ltd) (“the Lessor”), dated 12 May 1998;**

- Product Ruling application received from the applicant, dated 15 December 2000;
- Norfolk Ridge Vineyards Trust Deed between Norfolk Ridge Vineyards Ltd (formerly Egerton Vineyard Management Ltd) ('Manager'), Charters Securities Pty Ltd ('Trustee') and Norfolk Ridge Ltd (Egerton Vineyards Mt. Barker Ltd) ('Lessor'), dated 29 April 1998;
- **Lease and Management Agreement between Norfolk Ridge Vineyards Ltd (formerly Egerton Vineyard Management Ltd) (Manager), Charters Securities Pty Ltd (Trustee), Norfolk Ridge Ltd (formerly Egerton Vineyards Mt Barker Ltd) (Lessor) and the Grower;**
- Memorandum and Articles of Association of Norfolk Ridge Vineyards Ltd (formerly Egerton Vineyard Management Ltd), dated 4 December 1997;
- Agreement for Supply of Grapes between Norfolk Ridge Vineyards Ltd (formerly Egerton Vineyard Management Ltd) and an independent winemaker, dated 6 May 1998; and
- additional correspondence received from the applicant dated 15 June 2001 and 18 June 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.**

16. The documents highlighted are those that Growers 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 a Grower, will be a party to, which are a part of the arrangement. The effect of this agreement is summarised as follows.

### Overview

17. The arrangement is called the Norfolk Ridge Vineyard Project.

Type of business each participant is carrying on	A long term commercial viticulture business.
Location	Approximately 11 kilometres west of Mount Barker, Western Australia.
Number of hectares offered for cultivation	This Prospectus provides for up to 50 hectares to be planted
Possible total subscription	125 Leased Areas

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Size of each Leased Area	0.4 hectares
Minimum investment	1
Minimum subscription for Project	50 Leased Areas
Number of vines established per hectare	A minimum of 1,667 vines per hectare
The term of the investment	15 years
Initial Cost	\$20,800
Initial costs per hectare	\$52,000
Ongoing costs	Management Fees payable to the Manager for performing the services during the relevant years. Rent Fee. Manager's bonus of 55% of the value of grape produce received each year in excess of the projected total returns per leased area set out in the Prospectus. Additional insurances as required by the Grower

18. This arrangement is called the Norfolk Ridge Vineyards Project. The Project carries on a long term viticultural project upon land held by the Lessor. The Project Land is located in the vicinity of Mt Barker, Western Australia. The Project is for a period of 15 years.

19. Growers participating in the arrangement have entered into a Lease and Management Agreement between the Manager, the Lessor, the Trustee and the Grower. This agreement is set out in Schedule 2 of the Trust Deed.

20. The Agreement gives a Grower a lease from the Lessor over an identifiable area of land called a "Leased Area" until the Project is terminated on 31 December 2013.

21. Growers who entered into the Project leased land including planted vines on cleared land complete with dams, catchments, roads and firebreaks from the Lessor.

22. Under the Prospectus, the Manager offered minimum individual holdings of one leased area of 0.4 hectare. Overall, it was proposed that 50 hectares would be planted. The 125 leased areas this represents are identified on the plan of the vineyard attached to the Lease and Management Agreement. The Manager was able to accept oversubscription of an additional 75 leased areas. It was proposed that a minimum of 666 vines would be planted per leased area with 1,667 vines to be planted per hectare. The number of vines that have been planted per hectares is between 1,667 and 1,850. The Manager maintains a register of Growers, identifying the leased areas held by Growers.

23. Possible projected returns for Growers are outlined in the Prospectus. The projected returns are subject to the inherent risks of primary production and the commercial risks of a long-term venture of cultivating, growing and harvesting a commercial vineyard. The risks associated with the Project have been outlined in the Prospectus. Growers executed a Power of Attorney enabling the Manager to act on their behalf as required when they made an application for a leased area.

24. The Grower engaged the Manager to cultivate and maintain the leased area and to harvest and sell the grape produce. The Grower paid for the irrigation system and the trellising that was installed on the leased area. Unless the Grower elected to collect and market the grape produce from the leased area personally, the Manager will sell the grape produce on behalf of the Grower (clause 19 of the Lease and Management Agreement).

25. Growers also had an option to subscribe for shares in Egerton Vineyards Mt Barker Ltd.

26. The Manager has entered into an Agreement for Supply of Grapes with an independent wine maker. The wine maker has agreed to purchase a nominated tonnage of the projected grape crop for the first three years of production.

### **Trust Deed**

27. The Trust Deed established the Project and operates as a deed binding on all of the Growers of the Project, the Manager and the Trustee. The Trust Deed sets out the terms and conditions under which the Manager agreed to act for the Growers and to manage the Project and the Trust. The Trustee was appointed and agreed to act as trustee of the Trust and Fund, and as representative of the Growers. The Lease and Management Agreement is annexed to the Trust Deed and was executed on behalf of the Grower following the Grower signing the Application and a Power of Attorney form in the Prospectus. Pursuant to clause 21 the Manager keeps a register of Growers. Growers may assign their interest only in certain circumstances as set out in clause 18.

### **Lease and Management Agreement**

28. Under the Lease and Management Agreement a Grower makes payments for rental and management fees, and payments were made upon application for trellising and irrigation.

29. The Lessor has granted the Grower a lease of a leased area (set out in the Schedule attached to the Lease and Management Agreement) and the Grower:

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- will not use or permit any other person to use the leased area for any purpose other than that of commercial viticulture and the Project;
- will not erect any building or construction (whether temporary or permanent) on the leased area, except with the approval of the lessor and for the purpose of commercial horticulture and the Project; and
- will not use, or permit any other person to use the leased area for residential, recreational or tourist purposes.

30. In return, the Grower has the right to pass over the leased area at any time and the Grower will at all times 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 the benefit of the Grower. At the expiration of the term, the Grower will peaceably surrender and yield up to the Lessor the leased area free and clear of rubbish and in good and substantial repair order and condition.

31. The Manager has carried out the following services under this agreement:

- Planted suitable callused cuttings or vine rootlings on the leased area;
- Established a trickle irrigation system to the vines in the leased area;
- Erected suitable trellising systems to support the vines;

32. The Manager will carry out the following services under this agreement for the term of the Project:

- Maintain the trickle irrigation system to the vines in the leased area;
- Maintain the trellising system to support the vines;
- Cultivate, tend, train, prune, fertilise, spray, and otherwise care for the vines as when required;
- Use all reasonable measures to keep the leased area free from vermin, noxious weeds, pests and diseases;
- Maintain the leased area according to good viticultural practices;
- Replace any vines that fail to establish or that die during the first three years of the project; and
- Harvest the grapes grown on the leased area each year and despatch them for sale.

33. Prior to 31 December 1999 a Grower was able to exercise an option to collect and market their own collectable produce (clause 18). However, where no election was made, the Manager will harvest (clause 17) from the date of the first commercially harvestable grape crop the grape produce grown on the vineyard at such time or times as, in the opinion of the Manager, will maximise the price receivable for such grape produce for the purpose of making quality wines. The Manager will be responsible for paying for the annual cost of public liability insurance on the Leased Area (clause 21.1). The Grower will be responsible for additional insurances as required by the Grower such as vine and crop protection (clause. 21.2).

### **Fees**

34. The Growers made the following payments per leased area for the initial period of operation, being the period from the commencement date to 30 June 1999:

- a management fee of \$14,800 to Norfolk Ridge Vineyards Ltd for the management of the vineyard ;
- a lease fee of \$500 to Norfolk Ridge Ltd for lease of the Grower's leased area of the vineyard;
- cost of the irrigation system of \$2,500 to Norfolk Ridge Vineyards Ltd; and
- cost of trellising of \$3,000 to Norfolk Ridge Vineyards Ltd.

35. The Growers made the following payments per leased area in the second year of operation:

- a management fee of \$4,000 to Norfolk Ridge Vineyards Ltd for the management of the vineyard business for the period 1 July 1999 to 30 June 2000;
- a lease fee of \$515 to Norfolk Ridge Ltd for lease of the Grower's leased area of the vineyard for the period 1 July 1999 to 30 June 2000.

36. The Growers made the following payments per leased area in the third year of operation:

- a management fee of \$4,532 to Norfolk Ridge Vineyards Ltd for the management of the vineyard business for the period 1 July 2000 to 30 June 2001;
- a lease fee of \$583 to Norfolk Ridge Ltd for lease of the Grower's leased area of the vineyard for the period 1 July 2000 to 30 June 2001.

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37. Thereafter, the rent and management fees payable per leased area will be calculated with reference to the immediately preceding year increased by the greater of three percent or the percentage increase in the Consumer Price Index between the March quarter in the year of payment and the March quarter in the immediately preceding year.

38. A Grower grants and agrees to pay a bonus to the Manager equivalent to 55% of the value of grape produce received each year in excess of the projected total returns per leased area set out in the Prospectus. A Grower is liable for the cost of additional insurance fees payable if Grower requires additional insurance.

## Harvesting

39. The Manager will be responsible for the harvesting of the grape produce grown on the vineyard. The Harvest will commence from the date of the first commercially harvestable grape crop from the vineyard at such time or times as, in the opinion of the Manager, will maximise the price receivable for such grape produce for the purpose of making quality wines.

40. The Receipts from the sale of any grape produce sold by the Manager on behalf of Growers who have not elected to collect and market their collectable produce will be paid into a produce fund established by the Trustee. Receipts received by the Trustee are to be distributed in the following order of priority:

- any amount to which the Manager is liable to pay to the Trustee from any amount payable by the Manager on behalf of the Trust or the Project which the Trustee has not been paid from any other source;
- any annual contributions payable by a non-electing grower that are due and unpaid;
- payment of the portion of the Manager's bonus payable under clause 22.1.3 of Lease and Management Agreement;
- any amount payable by a non-electing grower to the Manager under the Lease and Management Agreement; and
- to the non-electing Grower in proportion to their respective proportional interest in the net sales proceeds (cl. 20.3.5).

**Finance**

41. Growers were able to fund their investment in the Project themselves, or borrow from an independent lender.

42. This Ruling does not apply if a Grower enters into a finance agreement that 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**

43. For a Grower who is an individual and who entered into the Project from 12 May 1998 until the issue of PR 1999/18 on 5 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 will decide for the income year ending 30 June 2001 that the rule in section 35-10 does not apply

to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 47 in the Explanations part of this ruling, below).

45. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any 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.

46. 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 subsection 35-55(1) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. 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**

47. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

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

48. 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.

49. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

50. For the purposes of applying the objective tests, 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 activity 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.

51. In broad terms, the objective 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 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 are used on a continuing basis in carrying on the business activity in that year (section 35-45).

52. A Grower who was accepted into the Project from 12 May 1998 until the issue of PR 1999/18 on 5 May 1999 and who has participated in the Project since that time is carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling and additional information provided since indicates that a Grower who acquired the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2004. Growers who acquired more than one interest in the Project may, however, pass one of the tests in an earlier income year.

53. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b),

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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.

54. 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, for an individual Grower who acquired an interest(s) in the Project from 12 May 1998 until the issue of PR 1999/18 on 5 May 1999, the Commissioner has decided that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the year ended 30 June 2001.

55. 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) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

56. Information provided by the applicant states 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 in this Product Ruling.

57. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report of the independent experts and additional evidence provided with the application by the Manager;
- the binding Supply of Grapes contract with the independent winemaker for the sale of grapes setting out prices that realistically reflect the existing market and projected market in the geographic region where the grapes are grown; and
- objective and generally available information relating to the viticultural industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

## Detailed contents list

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

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**Commissioner of Taxation**

27 June 2001

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

PR 1999/18; PR 1999/95; TR 92/1;  
 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

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- product rulings
  - public rulings
  - schemes
  - tax avoidance
  - tax benefits
  - viticultural expenses
- Legislative references:*
- 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)(a)
  - ITAA 1997 35-55(1)(b)
  - ITAA 1936 82KL
  - ITAA 1936 Pt IVA
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