



PR 2002/62 - Income tax: Kirribilly Estate Vineyard Stage 2

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Product Ruling

Income tax: Kirribilly Estate Vineyard Stage 2

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	32
Explanations	36
Detailed contents list	48

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.

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

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.

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 Kirribilly Estate Vineyard Stage 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 13 March 2000 and 13 March 2001. 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 15 May 2002 for Growers who, between 13 March 2000 and 13 March 2001, 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

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 13 March 2000 and 13 March 2001. 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:

- Information Memorandum of Kirribilly Estate Vineyard Stage 2, dated 13 March 2000;
- **Contract for Sale and Purchase of Land between Malcolm Bartholomaeus and Marion Bartholomaeus and the Grower, dated 29 May 2000;**
- **Vineyard Management Agreement between Kirribilly Vineyard Management Services Pty Ltd (Vineyard Manager), Jackson Vineshare Management (the Project Manager) and the Lot Owner, dated 26 May 2000;**
- Grape Purchase Agreement, between Kirribilly Vineyard Management Services Pty Ltd and Kirribilly Wines Pty Ltd, dated 15 May 2000;
- Community Plan By-Laws Scheme Description;
- Product Ruling application received from the applicant dated 14 January 2002;
- Correspondence from the applicant's representative dated 7 March 2002;
- Telephone Notes of conversations with the applicant's representative, 7 March 2002.

Note: certain information received from Kirribilly Vineyard Estate Stage 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. This arrangement is called Kirribilly Estate Vineyard Stage 2 and is summarised as follows:

Location	The Kirribilly Estate Vineyard Stage 2 is located on a site situated eight kilometres east of Clare, South Australia.
Type of business	Viticulture.
Number of hectares under cultivation	The total vineyard area is 141.2024 hectares. The area under cultivation pursuant to this Project is 124.2024 hectares.
Name of development	The Kirribilly Estate Vineyard Stage 2.
Size of participation	Vineyard Lots are irregular in size. There are 30 Vineyard Lots ranging in size from 2 hectares to 8.5 hectares.
The term of investment	Initial 10 year management agreement
Nature of investment	Freehold title over land (subject to Community Title).
Initial cost	A Grower subscribing in the year ended 30 June 2000 paid \$46,921 per hectare (planted June 2000) and \$44,097 (planted September 1999). This represents vineyard establishment, land and water rights and prepaid operating costs for the year ended 30 June 2000. Note GST was not applicable at the time.

Ongoing Costs	<p>Operating expenses on a per hectare basis of \$11,503 (2000), \$7,612 (2001), \$7,986 (2002) and \$7,923 (2003), excluding GST.</p> <p>Included in the operating expenses are Management Fees on a per hectare basis of \$9,500 (2000), \$1,500 (2001), \$1,519 (2002) and \$1,538 (2003), excluding GST.</p>
Expected production	It is expected that the first harvest will be in 2002 with full production to be reached by the 2005 harvest.

Description

18. Growers participated in the Project by:

- Entering into a 'Contract for Sale and Purchase of Land' with Kirribilly Limited to buy freehold title to land ranging in size from 2 hectares to 8.5 hectares, subject to Community Title. Most native vegetation had been removed, and soil testing had already been carried out. Under the terms of the Community Corporation By-Laws the land may only be used for viticulture.
- Entering into a 'Vineyard Management Agreement' with Kirribilly Vineyard Management Services Pty Ltd that relates to services to be performed in providing ongoing management of the vineyard.

Contract for Sale and Purchase of Land

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.

20. The purchase price of the Vineyard Lots of \$9,250 per hectare included an interest in the assets of the Community Corporation (which included an interest in the water licences and community property, i.e., improvements and any other infrastructure owned by the Community Corporation).

Vineyard Management Agreement

21. Growers entered into a Vineyard Management Agreement with Kirribilly Vineyard Management Services Pty Ltd to provide ongoing management of the vineyard for a period of at least 10 years. After 8 years the parties will meet with the intention of effecting the appointment of the Vineyard Manager for an extended term of five years. The parties then may negotiate to further extend the Vineyard Management Agreement for two further terms of five years.

22. Vineyard and community works establishment costs for vines planted prior to September 1999 were fixed at \$26,168 per hectare. For vines planted after September 1999 vineyard and community works establishment costs were fixed at \$23,344 per hectare. This included all establishment expenses such as buildings and infrastructure, drainage and soil preservation, irrigation and dam construction, land preparation, trellising and the supply and planting of vines.

23. Each hectare contained approximately 1,850 vines. The vines planted will be a combination of Merlot (10%), Shiraz (57%), Cabernet Sauvignon (25%), Malbec (7%), and Sangiovese (1%).

24. Under the terms of the Vineyard Management Agreement, Growers also appointed a Project Manager, for a period of 10 years, to manage and conduct the business and affairs of the Project. This role is performed by Mark Trevor Jackson, trading as, Jackson Vineshare Management ("Jackson Vineshare Management"). Jackson Vineshare Management is not related to, and is independent of Kirribilly Limited, the Vineyard Manager and the purchasing wineries.

25. The Project Manager is responsible for monitoring the establishment and management of the vineyards by the Vineyard Manager. The Project Manager was appointed Community Corporation Manager by the Community Corporation to be responsible for administering the Community Corporation's affairs.

26. The Community Corporation manager is responsible for discharging the statutory functions and business affairs of the Community Corporation. He is also responsible for monitoring the establishment and management of the vineyards by the Vineyard Manager.

27. The first harvest will be in March/April 2002.

28. The Vineyard Manager has entered into Grape Sale and Purchase Agreements with Kirribilly Wines Limited. These agreements provide for the purchase of 100% of the fruit produced by the vineyard up to the 2009 harvest, subject to certain quality criteria being achieved. In addition, Kirribilly Wines Ltd has options to purchase all the fruit from the vineyard for a further two consecutive five year periods.

29. The price to be paid for the fruit varies from fixed prices plus consumer price index and bonus payments for quality to market price as determined each year plus a bonus for quality. Under the Vineyard Management Agreement the fruit from each lot will be pooled and on sold to the purchasing wineries under power of attorney granted by the growers to the Vineyard Manager.

Finance

30. Growers were able to fund their involvement in the Project themselves, borrow from one of the preferred trading banks, or borrow from an independent lender.

31. 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

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

Section 35-55 – Commissioner’s discretion

32. For a Grower who is an individual and who entered the Project between 13 March 2000 and 13 March 2001, 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 2003 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 31 of this Product Ruling.

33. 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 39 in the Explanations part of this ruling, below);
- 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)).

34. 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.

35. 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

36. 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.

37. 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.

38. 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.

39. 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.

40. 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).

41. A Grower who was accepted into and who has participated in the Project since 13 March 2000 until 13 March 2001 is carrying on a business activity that is subject to these provisions.

42. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired the minimum allocation of 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 2004. Growers who acquired more than 2 hectares interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

43. 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.

44. 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 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.

45. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of 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 2004. 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 2003.

46. 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 31 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.

47. 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.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	17
Description	18
Contract for Sale and Purchase of Land	19
Vineyard Management Agreement	21
Finance	30
Ruling	32
Division 35 - Deferral of losses from non-commercial business activities	32

Section 35-55 – Commissioner’s discretion	32
Explanations	36
Division 35 - Deferral of losses from non-commercial business activities	36
Detailed contents list	48

Commissioner of Taxation15 May 2002

Previous draft:

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*Related Rulings/Determinations:*PR 1999/95; TR 92/1; TR 92/20;
TD 93/34; TR 97/16; TR 98/22*Subject references:*

- carrying on a business
- commencement of a business
- management fees
- non commercial losses
- primary production
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- agricultural 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)
- TAA 1953 Part IVA
- Copyright Act 1968
- South Australian Community Titles Act 1996

Case references:

- FCT v. Lau 84 ATC 4929

ATO references:

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