



# Product Ruling

## Income tax: Old Mundulla Vineyard Project 1998

Contents	Para
<b>What this Product Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
<b>Ruling</b>	<b>48</b>
<b>Explanations</b>	<b>52</b>
<b>Detailed contents list</b>	<b>62</b>

### *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 the Old Mundullah Vineyard Project 1998, 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').

### **Business Tax Reform**

3. 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.

4. Taxpayers who are considering investing 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**

5. 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 potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

### **Class of persons**

6. The class of persons to whom this Ruling applies is those who entered into the arrangement described below between 26 May 1999 and 30 June 1999. They 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 as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

7. The class of persons to whom this Ruling applies does not include persons who have terminated or 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**

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

9. If the arrangement described in this 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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11. This Ruling applies prospectively from 26 May 1999. 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 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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13. 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 enter into the specified arrangement on or after 26 May 1999 and before 30 June 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. The relevant documents, or parts of documents, incorporated into this description of the arrangement include:

- Prospectus issued by Blaxland Vineyards Ltd ('BVL') on 11 May 1998;
- Project Deed between BVL and Inteq Custodians Limited ('Inteq') and each several Grower, dated 1 May 1998;
- First Supplemental Deed between BVL and Inteq, dated 11 May 1998;
- Management Agreement (as amended on 5 May 1999) between BVL and Cardinal Financial Securities Limited (formerly Inteq) and each several Grower;
- Grape Purchase Agreement between Brian McGuigan Wines Limited ('BMWL') and BVL and each several Grower and Inteq, dated 1 May 1998;
- Vineyard Management Agreement between BVL and BMWL and Inteq, dated 1 May 1998;
- Administration Agreement between BVL and Vineyard Management Pty Ltd ('VMPL') and Inteq, dated 1 May 1998;
- Corporation Management Agreement between Community Corporation Inc ('CCI'), BVL, Andrew Paine Pty Ltd (APPL) and Inteq, undated;
- Application dated 20 November 1998 and letters from BDO Nelson Parkhill Services (Vic) Pty Ltd dated 13, 22 and 27 April 1999;

- Letter from Applicant dated 7 December 2000 and the “13 Month Experts Report” on the Old Mundullah Vineyard Project, prepared for BVL March 2000.

**Note:** certain information received from the applicant regarding the Project has been provided with an understanding that it is on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

15. The documents highlighted in paragraph 14 in bold are those that may have been entered into by the Grower. For the purposes of describing the arrangements to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which the Grower, or an associate of the Grower will be a party.

16. All Australian Securities and Investments Commission (ASIC) requirements have been, and 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 the Old Mundulla Vineyard Project. Growers were invited by the Manager to develop collectively a large vineyard, of up to 297 hectares, on a site at Mundulla in South Australia, 35 kilometres north east of Padthaway and 15 kilometres south east of Bordertown. A Grower or an entity associated with each Grower, was to have freehold title to the land through registered Community Title Lots (similar in concept to strata titles), with an independent representative monitoring the Vineyard Project on their behalf.

18. The Project was to be limited to 99 individual participation interests, each relating to a parcel of land 3.0 hectares in size. The minimum subscription is 5 participation interests. The initial term of the Project will be the period to 30 June 2013 with mechanisms for Growers to extend the term of the Project thereafter.

19. Each lot was to have approximately 2,025 vines per hectare planted on it. These were to grow on trellising with 1.6 metre posts. The grape varietal mix was to be determined by the Manager and was proposed to include Cabernet Sauvignon (40%), Shiraz (40%), Merlot (17%) and Petit Verdot (3%).

20. The Project was a prescribed interest vineyard managed by BVL. Participation in the Project involved two ‘stapled’ interests: Growers’ Interests and Community Title Lots. The freehold title three hectare Lots are subject to the *Community Titles Act 1996* (SA). Growers either own the Lot themselves or through an associated

**PR 2001/103**

entity. The Manager is engaged to manage the vineyard on behalf of the Grower.

21. The Growers' Lots were to be managed by BMWL. Approximately one half of the grapes were to be purchased by BMWL with the balance sold by BMWL as the Growers' agent.

22. The Project does not involve guaranteed returns or non-recourse financing. Nor are there risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

23. The fees payable by a Grower in the first four years commencing during the year ended 30 June 1999 are:

	Year 1 1999	Year 2 2000	Year 3 2001	Year 4 2002
Trellis	13,000	432		
Irrigation	15,000			
Preplanting (vine establishment) costs	3,000			
Vines	5,978			
Roads and buildings		1,250		
Vineyard maintenance	39,847	16,561	16,723	19,063
Administration	25,000	1,000	1,000	2,926
Total vineyard costs	101,825	19,243	17,723	21,989
Land cost	31,160			
Net investment	132,985	19,243	17,723	21,989

24. Growers who invested during the year ended 30 June 1999 were to pay the Year 1 fees after acceptance for services performed after that date. Growers will continue to pay Vineyard Maintenance and Administration costs during the term of the Project.

**Project deed**

25. The Project Deed dated 1 May 1998 governs the rights, duties and obligations of the Manager, the Representative and participants as Growers, Lot Owners or both. Growers or their associated entity were invited to purchase a 3 hectare Lot. Inteq was appointed as Representative under the Deed and agreed to act as representative of the participants in the Project with the capacity to review both the development and management of the vineyard over the period of approximately 15 years to 30 June 2013.

26. Growers employ the services of BVL pursuant to the Management Agreement for the cultivation, maintenance and marketing of the viticultural enterprise on the Lot owned by them or their associated entity.

27. Under the Deed, each Grower appointed the Representative as agent and attorney for the purposes of executing the Management Agreement and the Grape Purchase Agreement (cl 6).

28. The Representative has the power to:

- execute agreements on behalf of the Grower (cl 6.1(a));
- vary, cancel or replace any of the Project agreements or execute any documents (cls 6.1(b) and (c));
- use the money in the Agency Account to discharge the Grower's obligations (cl 36);
- receive and hold application moneys in the Agency Account (cl 35);
- invest the application moneys in any 'authorised investment' (cl 10).

29. During the term of the Project, each Grower who is not also a Lot Owner is granted a grower's licence and *profit à prendre* over the Lot by its associated entity (cl 6.6).

### **First Supplemental Deed**

30. The First Supplemental Deed dated 11 May 1998 between BVL and Inteq amended the Project Deed. Clause 5 of the Project Deed is amended to change the issue price and application price of each Lot to \$31,160.

### **Management Agreement**

31. The Management Agreement between the Representative (Inteq), the Manager ('BVL') and each Grower sets out the role and obligations of the Manager to control the Project. BVL, in turn, has entered into subcontracts with BMWL and VMPL and has contracted with APPL to manage the vineyard.

32. Upon termination of the Management Agreement, BVL will, within 3 months after termination, at its own expense remove all employees, agents, equipment, plant vehicles and machinery from the Grower's or associated entity's Lots (cl 15).

33. BVL was required to establish the vineyard on the Lots for each Grower in accordance with the development plan. BVL was to acquire vine rootlings for each Grower, and keep them separately identified as having been acquired on behalf of the Grower (cl 4.1).

34. The Vineyard Services to be provided by BVL are detailed at clause 4.3. These include, amongst other things:

- pruning;
- irrigation and fertilisation;
- soil management;
- vineyard maintenance;
- vermin and vegetation;
- insects and disease;
- spray diaries;
- destruction or abandonment of vines or grapes;
- management plan;
- restoration;
- incidentals.

35. Each Grower engages the Manager to harvest and deliver the grapes to the purchaser on behalf of each Grower complying with the Grape Purchase Agreement (cl 4.4).

36. A Grower may at any time terminate the Management Agreement if the Manager defaults in the performance of any obligation and the default is capable of remedy (cl 14.1).

37. All costs associated with providing the Vineyard Services are to be paid by the Manager out of the Management Fees and the Grower has no further liability unless the costs exceed the Management Fees. The owner of the Lot remains liable for the costs of ownership (cl 9.11).

## **Vineyard Management Agreement**

38. The Vineyard Management Agreement dated 1 May 1998 provides for the engagement of BMWL as an independent contractor to carry out the Vineyard Services for the Vineyard Fee (cl 3.1).

39. BMWL:

- must establish a vineyard on each Lot and provide Vineyard Services to the Manager on substantially the same basis as the Manager is to provide them to the Growers under the Management Agreement (cl 4.1);
- has similar reporting obligations as the Manager under the Management Agreement (cl 12) but makes no warranty about the quality and yield from any Lot (cl 4.2);
- will assist the Manager in relation to its insurance obligations under the Management Agreement (cl 7.1);

- must have sufficient rights of possession and occupation of the Lots to perform the Vineyard;
- Services and the Manager must ensure that no Grower interferes with that performance (cl 8.1).

### **Administration Agreement**

40. Under the Administration Agreement dated 1 May 1998 between BVL, Inteq and VMPL, the Manager engaged VMPL as an independent contractor to carry out certain administrative services during the term of the Project.

41. The Manager is to pay VMPL administration fees (cl 5) to:

- assist BVL with the administration and supervision of matters under the Project Deed (cl 4);
- liaise with and monitor the performance of BMWL under the Vineyard Management Agreement (cl 4.1);
- liaise with the purchaser in relation to matters the subject of the Grape Purchase Agreement (cl 4.2); and
- liaise with Growers in relation to matters concerning the vineyard (cl 4.3).

### **Grape Purchase Agreement**

42. The Manager, the Representative and each Grower have entered into a Grape Purchase Agreement with BMWL for the sale to BMWL, from vintage 2002 onwards, of the greater of 50% of each variety of grapes or 2,000 tonnes of grapes at market prices for the first 15 years of the Project (cls 3 and 4).

43. BMWL may act as agent for the Growers in selling the balance of the crop each year on a commission basis (cl 6).

### **Corporation Management Agreement**

44. The Corporation Management Agreement is between CCI, BVI, APPL and Inteq. The Agreement provides for the engagement of APPL as an independent contractor to perform the Financial Services and Corporation Services on and subject to the terms of the Agreement.

45. Administration and management services on behalf of the Community Corporation are:

- receipt and holding of money;

# PR 2001/103

- payment of money;
- preparation of accounts;
- collection of money;
- entering into contracts of insurance;
- maintaining and keeping records;
- issuing and signing notices;
- preparing minutes of meetings;
- providing information as required by the Act;
- investing money; and
- arranging for maintenance and repair of Common Property (cl 4.1).

46. Project services to be performed are:

- maintaining and keeping a register of Growers and Lot Owners;
- providing Growers and Lot Owners with tax return information;
- preparing CCL accounts; and
- assisting with financial management (cl 4.2).

## **Finance**

47. Growers can fund their investment in the Project themselves, borrow through an Australian bank organised by BVL or borrow from an independent lender. Finance arrangements organised directly by a Grower with independent lenders are outside the arrangement to which this Ruling applies. BVL has arranged for a credit facility to be offered by an Australian bank that has no interest in the Project. The loan will be on a full recourse basis. Other terms and conditions involved are:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full legal action against defaulting borrowers;
- none of the funds lent will be transferred back to the lender, or any associate, as part of any 'round robin', or equivalent transaction;
- the loan will not be a 'split-loan', of the type described in Taxation Ruling TR 98/22;

- no indemnity, or equivalent agreement, to reduce the borrower's liability applies;
- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about, the time of the making of the loan.

## **Ruling**

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

#### **Section 35-55 - Commissioner's discretion**

48. For a Grower who is an individual and who entered the Project on or after 26 May 1999 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income year ended 30 June 2001 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

49. 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 55 in the Explanations part of this ruling, below).

50. 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 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.

51. 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 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**

52. 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.

53. 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.

54. 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.’

55. 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 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.

56. 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 is used on a continuing basis in carrying on the business activity in that year (section 35-45).

57. A Grower who was accepted into, and who has participated in the Project since 26 May 1999 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 acquires 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.

58. Therefore, 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.

59. 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 on or after 26 May 1999 and prior to any withdrawal of this Product Ruling, 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. 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.

60. 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.

# PR 2001/103

61. 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 by the Responsible Entity with the application and subsequently, in further information requested by the Commissioner.

## Detailed contents list

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

	Paragraph
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to promoters and advisers	5
Class of persons	6
Qualifications	8
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
Overview	17
Project Deed	25
First Supplemental Deed	30
Management Agreement	31
Vineyard Management Agreement	38
Administration Agreement	40
Grape Purchase Agreement	42
Corporation Management Agreement	44
Finance	47
<b>Ruling</b>	<b>48</b>
Division 35 – deferral of losses from non-commercial business activities	48
Section 35-55 – Commissioner’s discretion	48

<b>Explanations</b>	<b>52</b>
Division 35 – deferral of losses from non-commercial business activities	52
<b>Detailed contents list</b>	<b>62</b>

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**Commissioner of Taxation**

 27 June 2001
 

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<i>Previous draft:</i>	- ITAA 1997 35-10
Not previously issued in draft form	- ITAA 1997 35-10(2)
	- ITAA 1997 35-10(3)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-10(4)
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1997 35-30
TR 97/16; TR 98/22; TD 93/34	- ITAA 1997 35-35
	- ITAA 1997 35-40
<i>Subject references:</i>	- ITAA 1997 35-45
- product rulings	- ITAA 1997 35-55
- public rulings	- ITAA 1997 35-55(1)
- non-commercial losses	- ITAA 1997 35-55(1)(a)
- primary production expenses	- ITAA 1997 35-55(1)(b)

*Legislative references:*

- ITAA 1997 Div 35
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## ATO references:

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