


IT 226 - Cattle leasing scheme - deductibility of expenses

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TAXATION RULING NO. IT 226

CATTLE LEASING SCHEME - DEDUCTIBILITY OF EXPENSES

F.O.I. EMBARGO: May be released

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LEASING OF CATTLE
CATTLE LEASING SCHEME
PRELIMINARY ACTIVITIES
PRELIMINARY EXPENSES

51(1)

FACTS

In an appeal against the decision of the Supreme Court of New South Wales which had upheld the findings of Taxation Board of Review No.1, the Federal Court of Australia reversed the decision of the lower tribunals and found that the taxpayer was conducting a business in preparation for the conduct of another business on a larger scale, that the payments made were outgoings of a revenue nature and that they were deductible under the second limb of section 51(1) (Ferguson v FC of T 79 ATC 4261; 9 ATR 873).

2. The case was concerned with the deductibility under section 51(1) of certain expenses associated with a cattle leasing scheme involving Charolais cattle.
3. The taxpayer was at all relevant times a serving officer in the Royal Australian Navy. At the time he entered into the scheme he held the rank of Lt. Commander and was expecting to retire in two or three years. Thereafter he had in mind to go into the business of raising fat cattle.
4. To establish a breeding herd he entered into an agreement under which he leased five half-cross Charolais heifers for a term of four years. The heifers were to be artificially inseminated or joined to pure bred Charolais bulls. Calves born to the leased cattle or their progeny were to be the property of the taxpayer. Contemporaneously he entered into an agreement with a company associated with the lessor which provided for the management of the heifers their progeny and descendants for a period of 10 years.
5. During the years ended 30 June 1973 and 1974 the taxpayer incurred leasing costs and management expenses totalling \$2370 and \$1258 respectively. He sought deductions for those amounts as losses and outgoings incurred in gaining or producing assessable income or in carrying on business for that purpose. Taxation Board of Review No.1 and, on appeal, the Supreme Court of New South Wales rejected the taxpayer's claim on the ground that he was not, at the time of incurring the

expenditure, carrying on business. Rather, he was merely acquiring the stock against the day when he would commence the business.

6. The Federal Court, however, has unanimously decided that, while the taxpayer may not have entered into the business of raising fat cattle, the preliminary activities of leasing and management represented a business venture in themselves with the result that the deductions claimed were allowable. The Federal Court attached considerable weight to the fact that the taxpayer expended a substantial part of his income on the project and that he had, or would have, the financial resources to carry out his retirement plan. The underlying justification for the Court's decision, however, seems to rest in the fact that the taxpayer had sold all the male progeny and received significant amounts therefor.

RULING

7. Notwithstanding the unsatisfactory features of the case, it has been decided not to pursue an application for special leave to appeal to the High Court. The decision of the Federal Court is essentially one of fact. In the circumstances it is unlikely that the High Court would grant special leave.

8. Because the decision is regarded as one turning on its own facts it will be necessary to critically examine all other cases to ascertain whether the Ferguson decision applies or whether it is to be distinguished. It is most unlikely that other taxpayers will have entered into cattle leasing schemes with the same degree of industry as did Ferguson. Where the available evidence indicates that the venture has a business-like flavour, was conducted systematically and the taxpayer had the necessary funds to finance his participation in the scheme, it should be accepted that a business of primary production was carried on.

9. Where participation in the scheme is seen as a means of tax avoidance and the taxpayer's participation in it is financed by a collapsible loan or similar finance arrangements it should not be accepted that the outgoings claimed have, in fact, been incurred. In these types of cases where there is no real outlay of money it should not be accepted that the taxpayer is carrying on business.

10. There are other cases, however, where the taxpayer is already carrying on a cattle raising business and enters into a cattle leasing scheme for the purpose of upgrading his herd by the introduction of one of the more exotic breeds found in cattle leasing schemes. In these cases it should be accepted that the lease and management charges are part of the outgoings of the existing business.

COMMISSIONER OF TAXATION