IT 2394 - Income tax : expenditure on irrigation and water and land conservation

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TAXATION RULING NO. IT 2394

INCOME TAX : EXPENDITURE ON IRRIGATION AND WATER AND LAND CONSERVATION

F.O.I. EMBARGO: May be released

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1210731	IRRIGATION AND WATER CONSERVATION	75B
	LAND DEGRADATION	75D
	PRIMARY PRODUCTION	

OTHER RULINGS ON TOPIC IT 252 IT 351 IT 352 IT 2339

PREAMBLE The purpose of this Ruling is to clarify the circumstances in which capital expenditure incurred by a primary producer on irrigation and water and land conservation measures qualifies for outright deduction in the year of the expenditure under section 75D or is deductible over 3 years under section 75B. The issue arises because the outright deduction previously allowable under section 75B was replaced, from 20 September 1985, with write-off over 3 years.

FACTS 2. Section 75B authorises an income tax deduction for capital expenditure incurred by a taxpayer carrying on a business of primary production on land in Australia on the construction, acquisition or installation of plant or a structural improvement primarily and principally for the purpose of conserving or conveying water for use in that business. The deduction is allowed in equal instalments over 3 years commencing with the year in which the expenditure is incurred.

3. The term 'plant or a structural improvement' appearing in section 75B is defined to include a dam, earth tank, underground tank, concrete tank, metal tank, stand for a tank, bore, well, irrigation channel or similar improvement, pipe, pump, water tower and windmill.

4. Section 75D provides an income tax deduction in the year of expenditure for capital expenditure incurred by a primary producer on a range of soil and land conservation measures including -

- an operation primarily and principally for the purpose of preventing or combating land degradation; and

- an operation (other than one consisting of the

draining of swamps or low-lying land) that consists of the construction of surface or sub-surface drainage works primarily and principally for the purpose of controlling salinity or assisting in drainage control.

5. The term 'land degradation' extends not only to soil erosion but also to the decline of soil fertility or structure, degradation of natural vegetation, the effects of deposits of eroded material and salinisation.

RULING

6. Both section 75B and section 75D contain a 'primary and principal' requirement. The requirement does not attach to the motives of a taxpayer in incurring expenditure dealt with by the two sections. It attaches to the result produced by the expenditure. In section 75B, for example, the plant or structural improvement must be for use primarily and principally for the purpose of conserving or conveying water. So also it is the primary and principal purpose of the operations referred to in section 75D which is decisive.

7. The 'primary and principal' requirement recognises that capital expenditure on irrigation and water and land conservation measures may be undertaken for more than one reason. For example, a dam may be built to hold and conserve water. It may also be built to act as a retention dam preventing excessive water run-off which could lead to soil erosion. Where the expenditure is incurred for dual purposes it will always be necessary to establish the primary and principal function or purpose of the result of the expenditure.

8. Although satisfaction of the primary and principal requirement is necessarily dependent on the facts of each case the approach taken to the following expenditures will serve as a guide to the operation of sections 75B and 75D.

Land Levelling or Grading

9. Capital expenditure on grading or levelling land used for primary production using traditional grading methods or more advanced laser assisted techniques is accepted as coming within the scope of section 75D, whether undertaken in connection with, or in isolation from, expenditure on irrigation. In Taxation Ruling No. IT 352 it is recognised that levelling measures in an irrigation area are generally undertaken by a primary producer with the object of preventing or combating land degradation. Prolonged irrigation of the land commonly results in salinisation and levelling the land is regarded as part of the process of preventing or combating salinity or drainage problems.

10. In improving the efficiency of irrigation practices land levelling may also lead to the conservation of water. The primary and principal purpose of land levelling is not to conserve water. Section 75B does not apply to it. In any event one of the requirements of the section is not satisfied, i.e. expenditure on land levelling does not result in an item of plant or a structural improvement.

Contour Banking

11. Contour banking is a means of containing or confining water within a set area on the land. It ensures a more even spread of water over an area being irrigated and enables water to be applied to the land with precision. More importantly, however, the purpose of contour banking is to ensure that water run-off is removed from the land in a graduated flow thus minimising damage to the land. Removing or conveying excess water from or over land in the least damaging manner is an important measure in soil conservation.

12. Although contour banking may improve the efficiency of irrigation practices essentially it is a measure designed to prevent soil erosion and, as such, expenditure on its construction qualifies for deduction under section 75D.

Dams

13. Capital expenditure on the construction of a dam would normally qualify for income tax deduction under section 75B. In a primary production business a dam is generally constructed for the primary and principal purpose of holding and conserving water for use in the business.

14. There may be exceptions to the general rule. It appears, for example, a retention dam may be built in a catchment area to prevent the washing away of soil by collecting run-off water and releasing it in a graduated flow through openings in the base of the dam. The dams are built with the prevention of erosion in mind rather than for water conservation purposes. Where a primary producer can establish that a dam is required to collect and efficiently drain water from the land in a regulated flow and that conserving water for subsequent use on the land is a minor object only it may be accepted the expenditure qualifies for income tax deduction under section 75D.

Irrigation Systems - irrigation channels

15. A properly constructed system of irrigation channelling includes channels both for conveying water to the land and for drainage from the land. One channel may serve a dual purpose, i.e. supply and drainage, or separate channels may exist for each purpose. Drainage channels are a preventative measure, i.e. they act to prevent degradation of the land resulting from inadequate drainage.

16. Where a primary producer installs drainage channels at the time of establishment of a whole irrigation system, section 75B determines the income tax deduction allowable, i.e. the deduction will be spread over 3 years. The reason for this is that the irrigation system as a whole (drainage channels being an integral part of an efficient system) is constructed primarily and principally for the purpose of conveying water for use on the land. In these situations section 75D is not considered to apply to any part of the expenditure.

17. It may occur that some existing irrigation systems include only supply channels and have no proper drainage system. Drainage channels may be constructed as a corrective measure to halt and repair damage already caused to the land. The cost of drainage channels constructed in these situations qualifies for deduction under section 75D.

Irrigation Systems - micro, drip, etc.

18. Irrigation systems of this nature involve the use of piping or tubing, whether it be metal or plastic. Their construction or installation is undertaken primarily and principally for the purpose of conveying water for use on land. Salinisation and soil erosion may be important considerations which will influence the choice, design, etc. of the system used. This does not alter the fact, however, that the principal and primary purpose is the conveying of water. Expenditure on their installation qualifies for deduction under section 75B.

19. Expenditure on a trickle irrigation system made of lightweight tubing, commonly used in the fruit and vegetable growing industry, is an allowable income tax deduction under sub-section 51(1) in the year in which the expenditure is incurred. In Taxation Ruling No. IT 2339 it is accepted that the expenditure is in the nature of an ordinary expense of operating an orchard or vegetable growing business and is not of a capital nature.

Soil Conservation Measures - initial watering

20. Where grasses are sown to combat soil erosion or saplings are planted for windbreaks water conveying equipment may be needed for initial irrigation. It is unlikely that regular irrigation would be necessary given that the object is to establish grasses or trees that will survive without assistance. Provided a deduction is not precluded by sub-section 75D(3) (for example a water truck would not qualify for deduction) the cost of installing watering systems for use in this initial period is regarded as part of the operation for preventing or combating soil erosion and qualifies for income tax deduction under section 75D.

COMMISSIONER OF TAXATION
9 April 1987