



# ***PR 1999/33 - Income tax: Mt Barker Vineyards Fig Tree Lane Vineyard Project***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 May 1999*



## Product Ruling

### Income tax: Mt Barker Vineyards Fig Tree Lane Vineyard Project

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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 98/1 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.*

## 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 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 Mt Barker Vineyards Fig Tree Lane Vineyard Project, or just simply as 'the Project' or the 'product'.

#### **Tax law(s)**

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 of the ITAA 1997;
- section 42-15 of the ITAA 1997;
- section 42-30 of the ITAA 1997
- section 100-55 of the ITAA 1997;
- section 387-165 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 388-55 of the ITAA 1997;
- subsection 44(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936');

- section 82KL of the ITAA 1936;
- section 82KZM of the ITAA 1936;
- Part IIIAA of the ITAA 1936; and
- the relevant provisions of Part IVA of the ITAA 1936.

**Class of persons**

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. 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 as set out in the description of the arrangement. In this Ruling these persons are referred to as ‘Growers’.

4. 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**

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate, or represent industry norms. A financial (or other) adviser should be consulted for such information.

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

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 43) 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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9. This Ruling applies prospectively from 26 May 1999, the date this Ruling is made. 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).

10. 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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11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2001. 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 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 material difference in the arrangement or in the persons' involvement in the arrangement.

## **Arrangement**

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12. The arrangement that is the subject of this Ruling is described below. The capitalisation of a term indicates that the term is defined in the relevant document or agreement. This description incorporates the following documents:

- Application for Product Ruling dated 8 February 1999;

- Compliance Plan for the Mt Barker Vineyards Scheme supplied with the Application;
- Constitution for the Mt Barker Vineyards Scheme supplied with the Application;
- Draft **‘Lease and Management Agreement’** between BGW Management Ltd (Responsible Entity), Mt Barker Land Company Ltd (Lessor) and the Grower, supplied with the Application;
- Copy of Mt Barker Land Company Ltd Constitution dated 11 January 1999 and supplied on 31 March 1999;
- Draft (No 4) Mt Barker Vineyards Fig Tree Lane Vineyard Project Prospectus dated 30 March 1999 supplied on 1 April 1999 and the subsequently amended Draft (No 8) Prospectus dated 15 April 1999 and supplied on that date;
- Draft Grape Sale Agreement between BGW Management Ltd and Vinnovate Australia Pty Ltd supplied on 14 April 1999;
- Amended Viticulturalist’s Report dated April 1999 for inclusion in Draft (No 8) Prospectus supplied on 14 April 1999; and
- Additional correspondence received from Ernst and Young dated 26 March 1999 and 14, 22, and 29 April 1999.

**Note: certain information received from the applicant, has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.**

13. 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 within the meaning of section 318 of the ITAA 1936, will be a party to, except for the provision of finance to which paragraphs 42 and 43 apply.

14. All Australian Securities and Investment Commission requirements are, or will be, complied with for the term of the Agreements.

15. The effect of these agreements relating to the Project is summarised as follows.

16. This arrangement is called the ‘Mt Barker Vineyards Fig Tree Lane Vineyard Project’ and has been registered as a managed

investment scheme under the Corporations Law. Growers entering into the Project must make the following payments:

- \$17,527 by 30 June 1999 comprised of \$3,283 for the acquisition and installation of trellises; \$1,610 for the acquisition and installation of irrigation items; \$1,174 for land ripping, rootstock and planting work; \$10,960 for management services to be provided in the first 13 months; and \$500 for rent;
- \$4,936 by 30 June 2000 for further management services to be provided in the second year plus an amount for rent calculated as the Year 1 rent indexed in accordance with the Consumer Price Index;
- \$5,059 by 30 June 2001 for management services to be provided in the third year plus an amount for rent calculated as the Year 2 rent indexed in accordance with the Consumer Price Index; and
- thereafter, an Annual Maintenance and Management Fee determined in accordance with Item 9(b) of the Schedule to the Lease and Management Agreement plus the previous year's rent indexed in accordance with the Consumer Price Index.

### **Years 1 to 3 per hectare rate**

17. The fees payable by a participant in the Project in the first three years expressed as the equivalent for a one hectare area of land, assuming rent is indexed at 2.5%, are:

	<b>Year 1 Hectare rate (2,220 vines)</b>	<b>Year 2 Hectare rate</b>	<b>Year 3 Hectare rate</b>
Management fee	\$27,400	\$12,340	\$12,648
Rent	\$1,250	\$1,282	\$1,312
Irrigation	\$4,025	Nil	Nil
Ripping/Rootstock/ Planting	\$2,935	Nil	Nil
Trellising	\$8,207	Nil	Nil
<b>Total</b>	<b>\$43,817</b>	<b>\$13,622</b>	<b>\$13,960</b>

The total years 1 to 3 cost to the Grower is \$71,399 per hectare.

**Overview**

18. Growers entering the Project will enter into a Lease and Management Agreement with Mt Barker Land Company Ltd and BGW Management Ltd.

19. Growers, or their associates, will acquire shares in the Mt Barker Land Company Ltd and Growers will lease land from the Mt Barker Land Company Ltd in Western Australia. The lease period will be for 17 years. The Growers will appoint BGW Management Ltd as Manager of their Vinelot.

20. There are 200 Vinelots on offer of 0.4 hectares each. The minimum area of land leased by each Grower is one Vinelot. The rootling stocking rate is 888 per Vinelot. The projected returns for Growers are outlined on pages 14 and 15 of the Draft (No 8) Prospectus. Those projections show that, over the life of the Project, projected income will exceed projected tax deductions by \$33,911, projected tax payments exceed tax refunds by \$16,449, pre-tax cashflows are positive to the extent of \$33,834 and after-tax cashflows are positive to the extent of \$17,383. BGW Management Ltd does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Lease and Management Agreements being offered pursuant to the Prospectus. The projected returns depend on a range of assumptions.

**Lease and Management Agreement**

21. Under Part 1 of the Lease and Management Agreement the Grower enters into a lease with the Mt Barker Land Company Ltd to lease a Vinelot of 0.4 ha for a term of 17 years (cl 2). Under the lease the Grower is required to pay rent (cl 3) in accordance with Item 7 of the Lease and Management Agreement Schedule. The annual rental under Item 7 is \$500 per Vinelot. Clause 3.2 then provides that that figure will be increased each year in line with the CPI.

22. The Grower can only use the Vinelot for commercial viticulture (cl 5.1) and is, at all times during the Term, required to develop the Vinelot for purpose of commercial viticulture (cl 5.2), keep it in good condition, and yield it and the Improvements up to the Lessor at expiration or determination of the lease (cl 5.3). The Improvements are defined in clause 31.1 as improvements made to the land by the Lessor including structural improvements such as dams, irrigation and buildings.

23. Clause 7.1 restricts the Grower from subletting, assigning or granting a licence over the Vinelot or the Improvements, except as provided for in clause 31, unless the assignee or transferee has satisfied certain requirements of the Lessor.

24. Under Part 2 of the Lease and Management Agreement, Growers contract with BGW Management Ltd to provide services to establish, operate and maintain the Vinelots (cl 12.1), to harvest (cl 16.1) and, should the Growers so elect, sell the grape produce on their behalf (cl 18.1). Alternatively, Growers may elect to collect their own grape produce (cl 17.1). Each Grower who does not opt to sell their own product is entitled to a proportionate share of the Gross Proceeds of Sale.

25. The services, referred to as the First Year's Services, Second Year's Services and Third Year's Services, which BGW Management Ltd contracts to provide to Growers, are detailed in Item 8 of the Schedule to the Lease and Management Agreement. These services relate to the administration and maintenance of operations; installation, maintenance and repair of the trellising and irrigation systems; planting and maintenance of the vines in accordance with good viticultural practice; and harvesting and sale of the fruit (if required by the Grower).

26. Under Part 3 of the Lease and Management Agreement (cl 31), at the time of entry into the Lease and Management Agreement:

- the Grower will grant a call option to the Mt Barker Land Company Ltd such that the Mt Barker Land Company Ltd can acquire the Vinelot Improvements (being the vines, trellising and irrigation equipment) to the Grower's Vinelot at the end of the project term; and
- the Mt Barker Land Company Ltd will grant a put option to the Grower such that the Grower can sell the Vinelot Improvements to the Mt Barker Land Company Ltd at the end of the project term.

The put and call options have an exercise price based on the market value of the improvements made by the Growers at cessation of the lease term. In the event that neither option is exercised, the Growers have an obligation to remove the improvements they have made to their Vinelot.

### **The Compliance Plan**

27. In the Compliance Plan (section 17), BGW Management Ltd states that it does not anticipate using an external custodian to hold the Project's assets. The Project's assets consist of the Application Fund (holding application moneys) and the Proceeds Fund (holding moneys from the sale of grapes). This is confirmed in the Draft (No 8) Prospectus, which notes at page 21 that, as BGW Management Ltd has net tangible assets of at least \$500,000, as defined in its dealer's licence, it is entitled to act as custodian in respect of the Project assets. Section 601FC(2) of the Corporations Law provides that the



responsible entity holds scheme property (the Scheme assets) on trust for the scheme members (the Growers) and must hold them separate from its own property. The Compliance Plan (section 6) establishes procedures for the holding of those assets, consisting entirely of cash, in separate trust accounts.

28. The Compliance Plan (section 13) also establishes the procedures for ensuring that BGW Management Ltd complies with its obligations to provide services under the Lease and Management Agreement. Amongst these stated procedures is the engagement of Turloch Pty Ltd as Trustee of the Turloch Unit Trust under an informal Service Agreement to provide those services. The arrangements between BGW Management Ltd and Turloch Pty Ltd are disclosed to potential applicants at page 12 of the Draft (No 8) Prospectus.

### **The Mt Barker Vineyards Scheme Constitution**

29. Clause 3 provides for the appointment of BGW Management Ltd as the Responsible Entity of the scheme and as trustee of the two funds to be established (the Applications Fund and the Proceeds Fund). The Applicant (Grower) will have an Proportional Interest in each fund.

30. Applicants may only make an application to enter into a Lease and Management Agreement with BGW Management Ltd at the Application Price shown in the Lease and Management Agreement and on the application form that forms part of the Prospectus (cl 4). The Application Price is defined to be that shown in the Lease and Management Agreement and must be payable in Cash. Cash is defined to include cheque, money order, bank cheque and, where permitted by BGW Management Ltd, credit card and direct Bank transfer. BGW Management Ltd is able to accept or reject the application and, if accepting, may accept subject to finance approval.

31. The Constitution (cl 12.4) provides that BGW Management Ltd will manage the business and ensure all services, required to be provided to Growers under the Lease and Management Agreement, are performed properly and efficiently where performed under the terms of a contract with any person (other than the Responsible Entity). This clause, with clause 16 (Appointment of agents), ensures that BGW Management Ltd is ultimately responsible for the services to the Growers under the Lease and Management Agreement but allows it to have those services performed by Turloch Pty Ltd.

32. Under clause 6, each Lease and Management Agreement specifying the Vinelot(s) is prepared and executed by BGW Management Ltd under a power of attorney, or by the Applicant, on or before the 30 June of the year in which the application is received.

33. Clauses 7, 8 and 9 deal with the release of the Application Moneys from the Application Fund. After BGW Management Ltd has satisfied itself that all formalities have been complied with, the Application Moneys will be released and applied to the payment of the first 13 month's fees payable under the Lease and Management Agreements. This includes those Lease and Management Agreements that were subject to finance but where the finance has become unconditional because it has been approved, and loan moneys have been received by BGW Management Ltd as clear funds.

34. Clause 12.5 provides that BGW Management Ltd is under no obligation to purchase or repurchase a Lease and Management Agreement from a Grower. Potential applicants are forewarned of this at page 12 of the Draft (No 8) Prospectus, although BGW Management makes commitments to Growers to assist in the creation of a secondary market, subject to the Corporations Law.

35. Clause 18 commits BGW Management Ltd to provide an Independent Viticulturalist's report in a year of planting and for years 2 to 5 following a year of planting, and to provide the report to each Grower within 30 days of receiving it.

36. Subject to the approval of BGW Management Ltd, clause 20 allows a Grower to assign the Lease and Management Agreement in the circumstances set out in clause 7 of the Lease and Management Agreement.

37. Clause 25 provides for the retirement or removal of BGW Management Ltd as Responsible Entity in accordance with the Corporations Law. Generally speaking, under Section 601FM of the Corporations Law, the members of a managed investment scheme may remove the responsible entity and choose another by the calling of a meeting and the passing of a special resolution.

38. Under clause 31, accounts will be drawn up and the Proceeds Fund distributed (after the sale of the grapes) on the basis of the Proportional Interest of each Grower who elects not to collect their fruit. It also commits BGW Management Ltd to provide annual tax statements to each Grower in respect of income and expenditure of the Project.

### **Mt Barker Land Company Constitution**

39. The Constitution of the Mt Barker Land Company Ltd provides, among other things, for the payments of dividends to Growers or their associates who have been allotted shares in accordance with the number of Vinelots held. The authorised capital of the Mt Barker Land Company Ltd is 10,000,000 ordinary \$1 shares and one 'B' class \$1 ordinary share. All shares have equal rights to capital and income. However, under clause 50, a holder of ordinary

shares shall have one vote per share limited to a maximum of 49.9 of the voting rights and the holder of the 'B' class share will be entitled to 50.1% of the voting rights. Turloch Pty Ltd holds the one 'B' class share. The provision giving Turloch the majority voting rights is disclosed at page 69 of the Draft (No 8) Prospectus.

**Agreement for the sale of grapes**

40. BGW Management Ltd have entered into an agreement for the sale of grapes with Vinnovate Australia Pty Ltd for 5 years from 2002 to 2006 (cl 3). The agreement sets out the rights and obligations of both parties and, in particular, gives Vinnovate rights in relation to the timing of harvest. Item 1 in Schedule 1 of the agreement sets out the varieties of grapes subject to the agreement. These varieties are those shown as being suitable for the Mt Barker area in the independent viticulturalist's report dated April 1999 and included in the Draft (No 8) Prospectus at pages 23 to 29.

41. The applicant has indicated in correspondence that there is no minimum subscription and that over subscriptions will not be accepted.

**Finance**

42. Growers may fund the investment themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is involved in the provision of financing for the Project.

43. This Ruling only applies to loan agreements that exhibit the following features:

- 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 lenders will take 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;
- there will be no indemnity, or equivalent, agreements to reduce the borrower's liability; and
- repayments of principal and payments of interest will not be linked to derivation of income from the Project,

and will be made regularly, commencing from, or about, the time of the making of the loan.

## **Ruling**

44. For a Grower who invests in the Project by 30 June 1999 and who incurs the fees set out in paragraph 16, and who utilises the services of the Responsible Entity, the following deductions will be available for the years ended 30 June 1999 to 30 June 2001:

Fee type	ITAA 1997 section	Deductions available each year		
		Year 1	Year 2	Year 3
		30/6/1999	30/6/2000	30/6/2001
<b>Management fee</b>	8-1	\$10,960	\$4,936	\$5,059
<b>Vinelot Rent</b>	8-1	\$500	\$513	\$525
<b>Irrigation</b>	387-125	\$537 - see Note (i) below	\$537	\$536
<b>Preplanting and planting of Vines</b>	387-165	see Note (ii) below		
<b>Trellising</b>	42-15	see Note (iii) below	\$427	\$427
<b>Interest on loan</b>	8-1	as incurred - see Note (iv) below	as incurred - see Note (iv) below	as incurred - see Note (iv) below

### **Notes:**

- (i) Deductibility under section 387-125 is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and for each of the next 2 years of income.
- (ii) A deduction under section 387-165 for expenditure on acquiring and planting the vines is calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in the year ended 30 June 2002 and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years, resulting in a write-off rate of 13%.
- (iii) Deductibility under section 42-15 for depreciation, for the year ended 30 June 1999, will depend, for the purposes of either section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method', on the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising. BGW Management Ltd is to advise Growers of this for the year

ended 30 June 1999. Deductions for the two succeeding years have been calculated, for illustrative purposes, on the basis of using the prime cost method at a rate of 13%, assuming that is the method that the Grower has chosen under section 42-25.

- (iv) Where a Grower has borrowed money for the acquisition of shares in the Mt Barker Land Company Ltd and those shares will be held by an associate of the Grower, any interest incurred, to the extent that it relates to the acquisition of those shares, will not be deductible.

### **Assessable income**

45. For a Grower who invests in the Project, gross income received by them from the sale of grapes from their Vinelot will be assessable income under section 6-5 of the ITAA 1997 in the year in which a recoverable debt accrues to them.

46. Dividends received by Growers or their associates from shares held in the Mt Barker Land Company Ltd will be assessable income under section 44(1) of the ITAA 1936 in the year in which the dividends are paid to them. Where those dividends are fully or partly franked, the provisions of Part IIIAA of the ITAA 1936 will apply.

### **Part 3-1: capital gains and losses**

47. To enter the Project, each Grower or an associate will subscribe for 3,700 ordinary \$1 shares in respect of each 0.4 Vinelot participation interest of the Grower. When those shares are disposed of by sale or otherwise, a capital gain or loss may arise.

48. Exercise of the put and call option in the 17th year of the Project, resulting in the sale of the Vinelot Improvements (the vines, trellising and irrigations system), may also give rise to a capital gain or loss.

49. Growers must include any net capital gain of an income year in their assessable income for that year, under section 100-55 of the ITAA 1997.

### **Depreciation recoupment**

50. The exercise of the put and call option in the 17th year of the Project, resulting in the sale of the Vinelot Improvements, will also give rise to a balancing adjustment under section 42-30 of the ITAA 1997.

**Sections 82KZM and 82KL; Part IVA**

51. For a Grower who invests in the Project the following provisions of the ITAA 1936 do not apply:

- the expenditure by Growers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

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**Explanations****Section 8-1**

52. Consideration of whether the management fees are deductible under section 8-1 proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

53. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision 8-1, provided it is not a loss of capital or expenditure of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business of growing grapes for sale at a profit, the gross sale proceeds from the sale of grapes from the Project will constitute assessable income under section 6-5. The generation of 'business income' from such a business, or future business, provides the backdrop against which to

judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, and maintaining of grapevines and the harvesting of the grapes.

54. Under the Lease and Management Agreement a Grower engages BGW Management Ltd to grow and harvest grapes from the Grower's Vinelot. Growers have the right to have the harvested grapes made available to themselves to sell or utilise how they wish. The purpose for which the participant utilises the grapes will then be a determining factor as to whether the amounts incurred on any management fee will be an allowable deduction.

55. This Ruling applies only to those parties engaging BGW Management Ltd to provide management services including the harvesting of the grapes and the selling of the grapes according to the terms of the Grape Sale Agreement or any similar commercial agreement for the sale of grapes.

### **Is the Grower in business?**

56. Generally, a Grower will be carrying on a business of viticulture where:

- they have an identifiable interest in growing vines coupled with a right to harvest and sell the grapes resulting from those vines;
- the viticulture activities are carried out on their behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to them carrying on such a business.

57. The Lease and Management Agreement gives Growers a chattel interest in the grapes on harvest. The Project documentation contemplates Growers will have an ongoing interest in the growing vines - the vines are the Growers' property and Growers have a legal interest in the land, being the lease itself, consistent with the intention to carry on a business of growing grapes. At the termination of the Lease and Management Agreement, Growers also have the obligation to remove the vines, trellising and irrigation system on their Vinelot, unless the put or call options, under which the Mt Barker Land Company Ltd acquires those Improvements, are exercised.

58. Growers have the right to use the land in question for grape-growing purposes and to have BGW Management Ltd come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over BGW Management Ltd, as evidenced by the Agreements and supplemented by the

Corporations Law, is consistent with ordinary business practices. Growers are able to terminate arrangements with BGW Management Ltd where certain conditions are not met.

59. Services provided by BGW Management Ltd under the Lease and Management Agreement include planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and all other operations necessary to develop a mature fruit bearing vine. These services are based on accepted viticultural practices and are of the type ordinarily found in grape-growing ventures. BGW Management Ltd also harvests the produce.

60. A grape-growing project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of grapes from the project will constitute gross assessable income. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes.

61. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

62. Given the nature of the Project, it is accepted that Growers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf.

63. The grape-growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities. The Growers' grape-growing activities will constitute the carrying on of a business when the Grower has entered into the Management Agreement and the Manager has commenced providing services.

64. The rent and management fees associated with the grape-growing activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of grapes), is to be derived. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions in section 8-1(2) do not apply, except as set out below.

65. Rent and management fees are pre-paid. Taxation Ruling TR 94/25 states that the facts in *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* (1993) 176 CLR 640; 93 ATC 4214; (1993) 25 ATR 95 were fundamentally different from those of a pre-payment and that the decision did not affect the deductibility of pre-



paid expenses. The lease and management fees will be incurred in the year of payment.

**Expenditure of a capital nature**

66. Any part of the expenditure of a Grower entering into a primary production business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. It is evident from the Project documentation that separate amounts are payable by Growers to cover the capital costs of carrying on their business as follows:

- vine establishment costs;
- irrigation; and
- trellising.

67. Expenditures of this nature can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production, and under the general depreciation provisions of the ITAA 1997.

**Subdivision 387-B: expenditure on conserving or conveying water**

68. Capital expenditure incurred by a person carrying on a primary production business, on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in such a business, qualifies for a write off over a three year period (i.e., 33 $\frac{1}{3}$ % with no pro rating required), under Subdivision 387-B, specifically, section 387-125. It is not necessary for a taxpayer incurring this expenditure to be the owner of the underlying land to claim the deduction, so long as they are in a business of primary production on the land. BGW Management Ltd will commence to carry on the primary production business on behalf of a Grower upon execution of the Lease and Management Agreement. Accordingly, a Grower's business of primary production will commence at the time the expenditure is incurred. The requirements of Subdivision 387-B have, thus, been met in this respect.

69. BGW Management Ltd has identified that the expenditure applicable to the conserving or conveying of water for the Vinelots, that meets the requirements of section 387-130, amounts to \$1,610. For a Grower entering into the Project by 30 June 1999 and commencing to carry on a primary production business by that date, a deduction will be allowable under section 387-125 for the years ended 30 June 1999 to 30 June 2001 inclusive, of \$537 per year.

70. However, a deduction under section 387-165 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and elects to do so.

### **Subdivision 387-C: vines and horticultural provisions**

71. The capital costs relating to establishing the vines are not able to be written off under Subdivision 387-D, as the Grower will not be the 'owner' of the vines for the purposes of these 'write-off' provisions. However, capital expenditure incurred in establishing horticultural plants can be written off where the plants are used in a business of 'horticulture' under Subdivision 387-C.

72. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the clearing of land.

73. By operation of section 387-165, a taxpayer is entitled to a deduction in respect of capital expenditure incurred on establishing a horticultural plant in an income year where the taxpayer:

- is the first to use the horticultural plant (or hold it ready for use) for commercial horticulture; and
- owns the plants when it is first used (or held ready for use) for commercial horticulture.

74. Under subsection 387-170(3), the definition of 'horticulture' covers the cultivation of grapevines. The vines are first used for commercial horticulture upon commencement of commercial production of fruit. Section 387-210 deems the rootstock to be owned by the Grower as lessee of the land. Therefore, the requirements for deductibility under section 387-165 are first satisfied when the grape vines enter their first commercial season. The write-off commences at that time (see sections 387-165 and 387-170).

75. The write-off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). The write-off deductions will, for a Grower who has entered into the Project and whose primary production business has commenced by 30 June 1999, start in the year ended 30 June 2002, on the basis that it is then the grapevines enter their first commercial season and hence begin to be used for the purpose of producing assessable income in a horticultural business.

76. BGW Management Ltd has identified that the relevant expenditure attributable to the establishment of the vines is \$1,174. For a Grower entering into the Project, no amount will be allowable as a deduction for the years ended 30 June 1999 to 30 June 2001. BGW

Management projects that the first commercial season will be the year ended 30 June 2002 and the write-off will, therefore, commence in that year.

***Alternative view***

77. The applicant has indicated disagreement with the view that the grapevines do not commence to be used for the purpose of producing assessable income in a horticultural business until their first commercial season, and has submitted an alternative view that the grapevines commence to be so used immediately after their establishment. This view is submitted by the applicant to be more consistent with the meaning of 'commercial horticulture' under the relevant provisions, the Commissioner of Taxation's previously stated views as to when a business commences and case law regarding the commencement of a business.

**Section 42-15: depreciation expenditure of trellising**

78. Growers accepted into the Project incur expenditure on trellising upon which the vines are attached and are to be used on their behalf in the operation of the vineyard business. This is attached to the land as a fixture. This expenditure is of a capital nature.

79. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

80. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

81. Under the Lease and Management Agreement, a Grower has the right to occupy certain land upon which they are entitled to grow vines to conduct a business of viticulture. The Lease and Management Agreement provides the Grower with an obligation to remove the trellising at the end of the Project, unless the put or call options are exercised.

82. The Growers will use the trellising in producing income from grape sales. The depreciation deduction is calculated by reference to

the effective life of the trellising. The depreciation deduction will be allowable from the day on which the trellising is installed. BGW Management Ltd will advise Growers when the trellising is installed and first used for the purpose of producing assessable income.

83. The cost of \$3,283, that relates to the acquisition and installation of trellises on the land, will be eligible for depreciation deduction by the Growers under section 42-15, at a rate of 13% prime cost or 20% diminishing value.

### **Interest deductibility**

84. Some Growers may finance their investment in the Project through a loan facility. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees. The interest expense incurred will be in respect of a loan to finance the establishment and development of the Vinelot, which will continue to be directly connected with the gaining of business income from the Project. These fees will, thus, have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

85. On the same reasoning, where the interest expense is in respect of a loan, or part of a loan, to acquire shares in the Mt Barker Land Company Ltd that will produce assessable dividends, the interest will be deductible under section 8-1. Where, however, the loan is taken out by the Grower but the shares will be held by an associate of the Grower, that part of the interest relating to the acquisition of the shares will not be incurred in gaining assessable income of the Grower and will not be deductible under section 8-1.

### **Assessable income**

86. Gross sale proceeds derived from the sale of grapes harvested from the project will be assessable income of the Growers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the terms of the specific sale contracts entered into.

87. Dividends paid to shareholders in the Mt Barker Land Company Ltd will be assessable income of the shareholder under subsection 44(1) of the ITAA 1936. 'Paid', in relation to a dividend, includes credited or distributed. Subject to the provisions of Part IIIAA, shareholders who include fully or partly franked dividends in their assessable income may be eligible to receive a rebate for tax paid by the Mt Barker Land Company.

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88. In the event that the Mt Barker Land Company Ltd is liquidated at the conclusion of the Project, further taxation considerations arise for the Grower or an associate holding shares in the Mt Barker Land Company Ltd. Any distribution made to a Grower or an associate on liquidation of the Mt Barker Land Company Ltd would be deemed to be a dividend to the Grower or the associate, to the extent of the undistributed profits of the Mt Barker Land Company Ltd. This dividend would be assessable as a normal dividend and may have franking credits attached.

## Capital gains and losses

89. The sale of the shares in Mt Barker Land Company Ltd and the exercise of the put and call option resulting in the sale of the Vinelot Improvements are CGT events for the purposes of Part 3-1 of the ITAA 1997. As a result of those CGT events occurring, a capital gain or loss may arise. If a capital gain arises the amount of that capital gain will form part of the Grower's, or the associate's, assessable income. If a capital loss arises the amount can only be offset against capital gains arising in the same year or in future years.

## Section 82KZM

90. Under the Lease and Management Agreement the rent and management fees of \$10,960 per Vinelot will be incurred upon entering into that Agreement. Fees and rentals are also payable for years 2 and 3 of the Project. These fees are charged for providing management services and lease of a Vinelot to a Grower. For this Ruling's purposes, no conclusion can be drawn from the arrangement's description that any part of these fees have been inflated to result in reduced fees being payable for subsequent years. The fees are expressly stated to be for a number of specified services. There is no evidence that might suggest the services covered by the fee in any particular year will not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, it can be accepted that no part of the fees for Years 1 to 3 are for BGW Management Ltd doing 'things' that are not to be wholly done within 13 months of the fees being incurred. On this basis, the basic precondition for the operation of section 82KZM of the ITAA 1936 is not satisfied and it will not apply to the expenditure incurred by Growers in the first 3 years of the Project.

## Section 82KL

91. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain

expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the ‘additional benefit’ plus the ‘expected tax saving’ in relation to that expenditure equals or exceeds the ‘eligible relevant expenditure’.

92. An ‘additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The ‘expected tax saving’ is essentially the tax saved if a deduction is allowed for the relevant expenditure.

93. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

#### **Part IVA**

94. For Part IVA of the ITAA 1936 to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Mt Barker Vineyards Fig Tree Lane Vineyard Project will be a ‘scheme’. The Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of the deductions in respect of rental and management fees for each Vinelot and possible interest on borrowings, allowable under section 8-1, and deductions allowable under Subdivisions 387-B and 387-C, and sections 42-15 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

95. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the grapes. Further, there are no features of the Project, such as the payment of excessive management fees or non-recourse loan financing by any entity that might suggest the Project was ‘tax driven’, and designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

### **Detailed contents list**

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## Part IVA

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*Previous draft:*

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*Related Rulings/Determinations:*IT 175; PR 98/1; TR 92/1; TR 92/20;  
TR 97/16; TR 98/22*Subject references:*

- business income
- carrying on a business
- commercial viticulture
- management fees
- product rulings
- public rulings
- taxation administration
- tax avoidance

*Legislative references:*

- ITAA36 44(1)
- ITAA36 82KH(1)
- ITAA36 82KL
- ITAA36 82KL(1)
- ITAA36 82KH(1F)(b)
- ITAA36 82KZM
- ITAA36 Part IIIAA
- ITAA36 Part IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 6-5

- ITAA97 8-1
- ITAA97 8-1(1)(a)
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- ITAA97 387-175
- ITAA97 387-185
- ITAA97 387-210
- ITAA97 387D
- ITAA97 388-55
- ITAA97 995-1(1)

*Case references:*

- *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* (1993) 176 CLR 640; 93 ATC 4214; (1993) 25 ATR 95

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