



PR 1999/48 - Income tax: Bridgeland Vineyards Project

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Product Ruling

Income tax: Bridgeland Vineyards 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

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 Bridgeland Vineyards 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 43-25 of the ITAA 1997;
 - section 387-125 of the ITAA 1997;
 - section 387-165 of the ITAA 1997;
 - section 82KL of the *Income Tax Assessment Act 1936* (‘ITAA 1936’);
 - section 82KZM of the ITAA 1936; and
 - 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 a result 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 24) 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

9. This Ruling applies prospectively from 2 June 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, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

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, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 31 March 1999;
- Draft Prospectus for the Bridgeland Vineyards Project dated 13 May 1999;
- Constitution of Bridgeland Vineyards Project;
- Lease and Management Agreement between Charters Securities Limited ACN 062 520 950 ('the Responsible Entity' or 'Charters'), Bridgeland Holdings Limited

ACN 078 747 538 ('the Lessor' or 'BHL'), Bridgeland Management Limited ACN 085 927 162 ('the Operations Manager' or 'BML') and each Grower;

- Contract for the Sale and Purchase of Grapes between Charters, BML and an independent buyer;
- Option Agreement for the Purchase of Land between BHL ('the Grantor') and the purchasers ('the Grantees');
- Vineyard Management Contract between Charters and BML; and
- Additional correspondence from Charters Securities Ltd dated 17 May 1999.

Note: certain information received 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 arrangements 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 of the Grower, will be a party to. The effect of these agreements is summarised as follows.

Overview

14. This arrangement is called the Bridgeland Vineyards Project. The Project is to carry out a large scale planting of grape vines upon land held by the Lessor and located in the vicinity of Margaret River, Western Australia. Growers entering into the Project will lease land from the Lessor for a period of 17 years. The minimum individual holding is one leased area, being an allotment of 0.2 hectares with an average of 296 vines. Overall, it is proposed to plant 97 hectares represented by 485 leased areas. Growers or their nominees are required to subscribe for shares in the Lessor. Participation in one leased area requires the Grower or nominee to subscribe for 3,000 shares at a cost of \$2 025.

15. Growers will enter into an agreement with the Responsible Entity, for the purchase and establishment of rootlings, the establishment of an irrigation system, and the management of the viticulture project. The Growers pay for the purchase and establishment of rootlings, trellising costs and irrigation system that is on their leased area. Growers may make an election to take possession of their grapes after harvest and be responsible for the marketing of the produce themselves. Where a Grower does not make this election, the Responsible Entity will sell the Growers' grapes on their behalf.

Lease and Management Agreement

16. The Growers will make payments to the Responsible Entity under the Lease and Management Agreement. Once the minimum subscription level is reached, applications will be executed as soon as practicable after they are received. These payments will be for rent, management fees, purchase and establishment of vine rootlings and irrigation expenses.

17. The Grower leases from the Lessor a defined area (as set out in Item 1 of the Schedule to the Lease and Management Agreement). Some of the conditions of the lease are that the Grower will not:

- use or permit any other person to use the leased area for any purpose other than that of commercial horticulture and the Project;
- erect any building or construction (whether temporary or permanent) on the leased area, except with the approval of the lessor and for the purpose of commercial horticulture and the Project; and
- use, or permit any other person to use the leased area for residential, recreational or tourist purposes.

18. In return, the Grower has the right to pass over the leased area at any time and the Grower will at all times have full right, title and interest in the Grower's grapes produced from the leased area. At the expiration of the term, the Grower will peaceably surrender and yield up to the Lessor the leased area free and clear of rubbish and in good and substantial repair, order and condition. The trellising remains the property of the Grower.

19. The Grower appoints the Responsible Entity to establish, maintain, supervise and manage on a day-to-day basis all activities to be carried on by the Grower on their leased area. The Responsible Entity is required to perform these duties in accordance with sound commercial practice and good horticultural practice. These services will be performed by the Operations Manager for the Responsible Entity. The Operations Manager will also arrange for the harvesting of the grapes.

20. Unless the Growers have elected otherwise, the Responsible Entity is authorised to enter into a contract as agent of the Growers for the sale and marketing of the grapes. The Responsible Entity and the Operations Manager, on behalf of the Growers, have entered into a long term contract for the sale of all Non Electing Growers' grapes to an independent company, which will pay a minimum price or market value, whichever is higher, for the produce.

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Fees

21. The Growers will make the following payments per leased area for the initial year of the Project:

- \$1,077 to the Responsible Entity for the purchase and establishment of rootlings;
- \$980 to the Responsible Entity for irrigation costs;
- \$10,353 to the Responsible Entity as management fees for services to be provided in the following 13 months; and
- \$626 to the Lessor for lease of the Grower's leased area of the vineyard for the period 30 June 1999 to 30 June 2000.

22. The Growers will make the following payments per leased area in subsequent years until the completion of the 17 year project period:

- a management fee of \$1,500 in each of Years 1 and 2 and \$1,700 in Year 3. This fee will be increased yearly by the greater of three percent or the percentage increase in the Consumer Price Index Australia (All Groups) from the immediately preceding year;
- a lease fee of \$626 to the Lessor for the leased area each of Years 1 and 2. This fee will be increased yearly by the greater of three percent or the percentage increase in the Consumer Price Index Australia (All Groups) from the immediately preceding year; and
- amounts for the purchase and installation of trellising systems amounting to \$1,824 in Year 1 and \$625 in Year 2.

Finance

23. Growers can fund their investment in the Project themselves, borrow from an independent lender, or borrow through finance arrangements organised by the Responsible Entity. Finance arrangements organised directly by a Grower with independent lenders are outside the arrangement to which this Ruling applies.

24. The Responsible Entity has engaged the services of Laton Consolidated Pty Ltd ('Laton'), a company not associated with the Responsible Entity or any associated entities, to broker loans from nominated independent lenders, to cover the fees payable to the Responsible Entity.

25. The loans brokered by Laton will be on normal commercial terms of the particular lender; they will be in form and substance, full recourse, and borrowers will be obliged to make regular repayments regardless of any income derived from the Project. The Responsible Entity will receive funds directly as a result of these loans, upon the Growers being accepted as borrowers. The Responsible Entity will not be placing any of these funds on deposit with Layton, the lender or any associated entities of Laton, the Responsible Entity or the lender but will substantially use these funds in carrying out its obligations under the Management Agreement.

26. Apart from the arrangement with Laton there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Project.

Ruling

27. For a Grower who invests in the Bridgeland Vineyards Project the following deductions will be available:

- rent paid by the Grower in relation to the leased area will be an allowable deduction in the year incurred (section 8-1);
- management fees paid for the services outlined in the Lease and Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1);
- depreciation of trellising will be an allowable deduction to the Growers (section 42-15) at a rate (determined under section 42-125) of 20% per year diminishing value or 13% per year prime cost;
- expenses incurred on irrigation will constitute allowable deductions to the Grower in the year incurred and in the next two years at the rate of 33.3% per annum (section 387-125); and
- a deduction for the cost of vine establishment will be allowable, at a rate of 13% per annum, calculated from the income year that the vines first become commercially productive (section 387-165).

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Sections 82KZM and 82KL; Part IVA

28. For a Grower who invests in the Arrangement the following provisions of the ITAA 1936 have application as indicated:

- 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 in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Assessability of income from the Project

29. Growers who invest in the Project will be assessable on their share of the gross proceeds arising from the Project (section 6-5).

Explanations

Section 8-1: Lease and Management fees

30. Consideration of whether Lease and Management fees are deductible begins with an examination of paragraph 8-1(1)(a). To be deductible under this paragraph:

- the outgoing must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under paragraph 8-1(1)(b) if it is 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 no 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.

31. A viticulture business can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a

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.

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

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes produced;
- the viticulture activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators, as developed by the Courts, point to the carrying on of a business.

33. Under the Lease and Management Agreement, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. The Grower appoints the Responsible Entity to establish, maintain, supervise and manage on a day-to-day basis all activities to be carried on by the Grower on their leased area. These services will be performed by the Operations Manager for the Responsible Entity. The Operations Manager will also arrange for the harvesting of the grapes.

34. The Lease and Management Agreement gives Growers an identifiable interest in specific grapevines and Growers have a legal interest in the land by virtue of the lease. Growers may elect to personally market the grapes attributed to their leased area or the Responsible Entity is authorised to market the grapes for them.

35. Growers have the right to use the land in question for viticulture purposes and to have the Responsible Entity come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over the Responsible Entity, as evidenced by the agreement and supplemented by the Corporations Law, is sufficient. Growers are entitled to receive regular progress reports from the Responsible Entity. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect. The activities carried out in the Agreement are carried out on the Growers' behalf.

36. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The independent viticulturist's report considers that the Project is realistic

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

37. Growers will receive the benefit of professional services through the Responsible Entity and its appointed Responsible Officer and Operations Manager. These services are based on accepted viticulture practices and are of the type ordinarily found in viticulture activities that would commonly be said to be businesses.

38. Growers have a continuing interest in the grapevines from the time they are acquired until the end of the 17 year Project. There is a means to identify which grapevines Growers have an interest in. The viticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' vineyard activities will constitute the carrying on of a business.

39. The fees associated with the viticulture 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 gained from this business. They will be deductible under the paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fees is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions in subsection 8-1(2) do not apply.

40. Lease 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 4124; (1993) 25 ATR 95 were fundamentally different from those of a prepayment 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

41. Any part of the expenditure of Growers entering into a horticultural 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. In this Project the costs of purchasing and establishing the vines, irrigation and trellising are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However,

expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

42. The Responsible Entity has identified the relevant expenditures that are of a capital nature. Growers entering into the Project incur and pay a separate amount to the Responsible Entity for these items, amounting to \$4,506. These amounts are identified at paragraphs 21 and 22 of this Ruling

Section 42-15: trellising expenditure

43. Growers accepted into the Project incur expenditure on trellising, upon which the vines 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.

44. 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.

45. However, it is accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Income Tax 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.

46. A Grower accepted into the Project enters into a lease for a right to occupy certain land upon which they are entitled to grow vines to conduct a business of a vineyard. Subject to the terms of the Lease and Management Agreement, they have a right to remove the trellising at the end of the Project.

47. The Responsible Entity will advise Growers of the date when the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of the trellises on the land will be eligible for a depreciation deduction by the Growers under section 42-125 at a rate of 13% prime cost or 20% diminishing value from this date.

Section 387-125: irrigation expenditure

48. Section 387-125 allows a taxpayer who is carrying on a business of primary production on land in Australia, to claim a

deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

49. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or a lessee, a deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the irrigation system.

Section 387-165: horticulture expenditure

50. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. 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 clearing land. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grapevines. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

51. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. The Responsible Entity will advise the Grower of this event.

52. Under this Subdivision, if the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

53. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines will have an effective life in excess of 13 years. The write-off rate for horticultural plants with an effective life of 13 to 30 years is 13%.

Section 82KZM

54. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be deductible, in full, under section 8-1. This section applies if certain expenditure incurred under an agreement is in return for the doing of a

thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

55. Under the Lease and Management Agreement, a Management fee of \$10,353 per leased area will be incurred upon execution of the Agreement. This fee is charged for providing services to a Grower only for the period of 13 months from the execution of the Agreement. For the purposes of this Ruling, no explicit conclusion can be drawn from the Arrangement's description, that the fee has been inflated to result in reduced fees being payable for subsequent services. There is no evidence to suggest the services covered by this fee could not be provided with 13 months of the fee being incurred. Therefore, it cannot be suggested that the 'thing' to be done cannot be done within 13 months of the fee being incurred.

56. The basic precondition for the operation of section 82KZM is not satisfied and the section will not apply to disallow a deduction for the Management Fees.

Section 82KL

57. 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' and the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

58. 'Additional benefit' (as defined in 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.

59. Section 82KL's operation 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

60. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into or carrying out the scheme to enable the relevant taxpayer to obtain a tax benefit in connection with the relevant scheme (section 177D).

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61. The Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions per leased area 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.

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

Section 6-5: assessable income

63. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers, under section 6-5.

64. Once harvested, the Growers' grapes will, in most circumstances, be trading stock of the Growers. As a consequence, if grapes are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-5 of the ITAA 1997. In Taxation Ruling IT 2001, it is accepted that costs associated with the establishment of a vineyard do not form part of the trading stock ultimately produced by the vineyard.

Detailed contents list

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Commissioner of Taxation
2 June 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

IT 175; IT 2001; PR 98/1; TD 93/34;
 TR 92/1; TR 92/20; TR 97/11;
 TR 97/16

Subject references:

- capital gains tax
- carrying on a business
- commencement of business
- fee expenses
- horticulture
- insurance expenses
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- management fees expenses
- product rulings
- public rulings
- primary production
- primary production expenses

- producing assessable income
- rental expenses
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA1936 82KH(1)
- ITAA1936 KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 Pt 2-5
- ITAA1997 6-5

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- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
- ITAA1997 8-1(1)(b)
- ITAA1997 8-1(2)
- ITAA1997 42-15
- ITAA1997 42-125
- ITAA1997 43-25
- ITAA1997 387-125
- ITAA1997 387-165

- ITAA1997 387-170(3)

Case references:

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

ATO references:

NO 99/5451-1

BO

FOI number: I 1019742

ISSN: 1039-0731

Price: \$1.60