PR 1999/53 - Income tax: Terra Australis Vineyard Project

Product Ruling
Income tax: Terra Australis 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

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 person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Terra Australis 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:

- sections 8-1, 42-15, 387-55, 387-125 and 387-165 of the *Income Tax Assessment Act 1997* ('ITAA 1997'); and
- sections 82KL, 82KZM and Part IVA of the *Income Tax Assessment Act 1936* ('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 44) 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 9 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, this 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 1999. 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

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

- amended application for Product Ruling dated 4 April 1999;
- The Terra Australis Vineyard Project Prospectus dated 18 May 1998 ('the Prospectus');
- Supplementary Prospectuses dated 18 June 1998 and 7 September 1998;
- draft Supplementary Prospectus received by the Australian Taxation Office ('the ATO') on 14 May 1999;
- Project Deed between Terra Australis Vineyard Project Limited ('TAVPL' or 'the Manager') and Australian Rural Group Limited ('ARG' or 'the Trustee') dated 27 April 1998 and Supplemental Deed dated 18 June 1998;
- Revised Management Agreement between TAVPL and each Grower received by the ATO on 14 May 1999;

- Revised Farm Allotment Agreement between the Manager and each Grower received by the ATO on 31 May 1999;
- draft Lease Agreement between Landeron Pty Ltd ('Landeron') and ARG and draft Sublease between ARG and the Manager for part of the property known as 'Medway';
- Lease Agreement between Terra Australis Vineyards Pty Ltd as trustee for the Terra Australis Unit Trust ('the Landowner') and ARG and Sublease between ARG and the Manager for the property known as 'Golden Nugget';
- draft Lease Agreement between Landeron and ARG and draft Sublease between ARG and the Manager for the property known as 'Whistling Duck';
- copy of Laton Finance Group/Nominated Bank Personal Loan Package;
- letter from the ATO to TAVPL dated 12 May 1999;
- letter from TAVPL to the ATO dated 13 May 1999;
- letter from the ATO to TAVPL dated 21 May 1999; and
- letter from TAVPL to the ATO dated 22 May 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 of the Grower, will be party to. The arrangement is summarised as follows:

14. The arrangement is called the 'Terra Australis Vineyard Project'. In the Prospectus, participants are invited to conduct a primary production business of growing, harvesting and selling wine grapes for a profit. The Project's vines will be grown on three separate properties in central New South Wales.

15. The Project is to run for a period of 19 years, ending on 30 June 2017. A Grower's minimum investment in the Project is the purchase of one 'Farm' or 'Allotment'. Each Farm has 560 wine grape vines planted on an individually identifiable area of 0.25 hectare.

16. Statements in the Prospectus indicating a Grower will be allocated vines on all three properties have been amended by the draft Supplementary Prospectus. A Grower will instead be allocated vines on only one of the three properties, but the Grower will share in the income generated from all three properties. This will be achieved by pooling the sales proceeds from all three properties and then distributing them among all the Growers.

17. The distribution of pooled sales will be based on the number of Farm(s) each Grower owns as a proportion of the total number of Farms within the Project. The distribution will be independent of the grape quality or quantity produced by each Grower's Farm, except where a Grower's Farm is partially or totally destroyed, in which case the Grower's share of the pooled sales will be adjusted to reflect the reduced number of vines on the Grower's Allotment.

18. The Prospectus, having expired on 1 May 1999, will be extended by the applicant to 30 June 1999 by the draft Supplementary Prospectus. No investors will be accepted into the Project after this date.

19. The Project is currently in its second year, subscriptions having previously been offered through the Prospectus in the year ended 30 June 1998. The minimum subscription was originally set at 675 Farms and was reduced to 150 Farms by Supplemental Deed dated 18 June 1998. The minimum subscription was reached as a result of the 1998 subscriptions.

20. If the maximum subscription is achieved, the Project will have 1,350 Farms utilising a total area of 338 hectares. Grape vines will be planted on the following properties:

- **'Medway'**, a 200 hectare property located 10 kilometres south of the town of Forbes in New South Wales. 'Medway' is partly developed with vines planted in 1996 and 1997. At present, it is owned and leased by entities within another vineyard project. A subdivision is currently in progress to separate an area totalling 88 hectares for use by the Project. The Manager anticipates the subdivision will be finalised by no later than the end of May 1999. Following subdivision and release of the current lease over 'Medway', ownership will be transferred to Landeron. Of the 88 hectares for use by the Project, 71.5 hectares is already developed with vines planted in 1996 and 1997. The Manager will pay a rental to Landeron for use of the existing vines, trellising and irrigation system on Medway.

- **'Golden Nugget'**, a 90 hectare property located 9 kilometres from the town of Young in New South Wales. This property was purchased by the Terra Australis Unit Trust ('the Landowner') during the year ended 30 June 1998. The Manager has advised that, as at the date of this Ruling, initial development has commenced on this property.
- **'Whistling Duck'**, a 160 hectare property located 20 kilometres east of the town of Forbes in New South Wales. This property will be owned by Landeron. Options to purchase this property, held at the date of the Prospectus, have expired. The Manager advises there is a verbal understanding with the Vendor to enable purchase of this property. If this particular property is not purchased, a property of equivalent size and quality will be substituted.

21. The Landowner and Landeron, as applicable, will lease the Project land to ARG who will then sublease the land to the Manager. The Manager will then enter into a Farm Allotment Agreement with each Grower, granting the Grower a licence to occupy an individual Farm.

22. The Manager will plant the Project's undeveloped land, a total of 266.5 hectares, with an average of 2,240 vines per hectare in the first 13 months following execution of the Farm Allotment Agreement.

23. Possible projected returns for Growers are outlined on pages 10 and 11 of the Prospectus. These depend upon a range of assumptions made by the Manager and include income projections from vines that were to have been planted by the Manager in 1998. The ATO is aware that the total 1998 planting schedule has been deferred until 1999. The Manager has assured the ATO this deferment will have no effect on the projected returns as outlined in the Prospectus. This Ruling gives no assurance or guarantee whatsoever in respect of the future success of or financial returns associated with the Project.

Farm Allotment Agreement

24. Each Grower enters into the Farm Allotment Agreement with the Manager until the termination of the Grower's interest or 30 June 2017, whichever is the earlier (clause 2.3(b)). Under the Agreement the Manager grants a licence to the Grower to occupy an Allotment for the establishment, growing, maintenance, harvesting and sale of grapes.

25. The licence fee payable in year 1 is $100 (clause 7.1(b)). The fee for each subsequent year is equal to the fee of the previous year indexed by the All Groups Consumer Price Index ('CPI'), in accordance with the formula in clause 7.2.

26. The right to occupy an Allotment may be assigned (clause 9). No Grower will have an exclusive right to occupy an Allotment (clause 2.2). The Manager may, during the term of the Agreement, relocate the Grower's Allotment to such position as the Manager in its absolute discretion determines (clause 6.2(a)). In the event a Grower is relocated to a different Allotment, the Grower will no longer be entitled to rely on this Ruling.

27. At the end of the Agreement the Grower must return the Allotment to the Manager in good condition (clause 3.2(a)). At this time the Grower may, but is not required to, remove the vines and trellising from the Allotment. If vines and trellising are not removed, the Manager will offer compensation to the Grower of $2,678, or a pro rata amount, to reflect the number of vines removed (clause 3.2(b)).

Management Agreement

28. Each Grower enters into a Management Agreement with the Manager until the termination of the Grower's interest or 30 June 2017, whichever is the earlier (clause 3(b)). Under the Agreement, the Manager must carry out the duties that are usual or necessary for carrying on a business of establishing the vines on the Grower's Allotment in a manner according to sound viticultural and environmental practices. Clause 4.1 details the duties to be carried out by the Manager in the first 13 months of the Agreement. These duties include:

- preparing the Grower's Allotment so that it will be suitable for the planting and growing of a sufficient number of vines;
- ensuring the Grower's Allotment has adequate drainage;
- supplying vine rootlings sufficient to plant fully the Grower's Allotment;
- tending and planting the rootlings;
- establishing irrigation and water management;
- carrying out weeding;
- building and maintaining required roads, tracks and fences;
- preventing and combating land degradation;

- providing suitable fertilisation; and
- eradicating, as far as possible, pests.

29. From the beginning of the 14th month onwards, the Manager must continue to maintain the Grower's Allotment. The Manager's on-going duties are prescribed in clause 4.3 and include weeding, fertilisation, pest eradication, vine replacement, harvesting and marketing of grapes.

30. The Manager is entitled to delegate all or any of the functions to be performed by it pursuant to the Management Agreement (clause 9).

31. Growers may elect to weed their own Allotments and it may result in the Manager reducing the amount of fees payable by the Grower (clause 5.1). Growers may also elect to have their vines harvested separately (clause 5.2) and have their grapes made available to them to sell or deal with as they determine (clause 5.3). Any Grower who makes an election under clause 5.1, 5.2 or 5.3 will be outside the arrangement to which this Ruling applies and will be unable to rely on this Ruling.

32. The Manager will pool for sale the produce of each Grower's Allotment with that of each other Grower and will market and sell all such produce. The proceeds of the pooled sales will be credited to the account of each Grower based on the number of Allotments the Grower holds in proportion to the total number of Allotments within the Project. The allocation of sales proceeds to each Grower does not make reference to the grape quality or quantity produced by the Grower's individual Allotment (clause 4.5(b)). However, if the Grower's Allotment is partially or totally destroyed then the Grower's share of the pooled sales will be adjusted to reflect the reduced number of vines on the Grower's Allotment (clause 4.5(c)).

33. The Grower may terminate the Management Agreement in certain instances, including where the Manager defaults in the performance of its duties (clause 11).

34. Once a Grower has engaged the services of the Manager, the Manager will be responsible for planting 560 vines on the Grower's Allotment no later than 13 months after the Agreement has been executed. For Growers who enter the Project on or before 30 June 1999, the Manager will have undertaken certain preplanting work for them before this time.

Other undertakings by the Manager

35. The Manager has provided the ATO with the following undertakings:

- to contact Growers to provide them with the correct date of commencement of the vines' first commercial season, in the event that it differs to the estimated date of 1 July 2000, for purposes of the horticultural write-off provisions; and
- to contact Growers and provide them with the correct date of trellising installation, in the event that it differs to the estimated date of 31 December 1999, for purposes of calculating the depreciation deduction.

Project Deed

36. Growers who enter into a Management Agreement with the Manager, will be covered by the Project Deed dated 27 April 1998 and Supplemental Deed dated 18 June 1998 effected between the Manager and ARG. By entering into the Management Agreement, Growers agree to the terms of the Project Deed.

37. Under the Deed, the Manager agrees to ensure that all works and services necessary to achieve the objectives of the Project are carried out and performed. The Manager will advise each Grower of the exact location of the Grower's Farm upon acceptance of the Grower's application (clause 6.1). Each Grower's vines will be identified by reference to certain row numbers within blocks. The Manager will notify the Grower by way of a copy of the Management Agreement and Farm Allotment Agreement, which will be forwarded to the Grower immediately on acceptance of the Grower's application.

38. ARG will act in a trustee capacity for the Grower to review, on a continuing basis, the development and management of the vineyard over the period to 30 June 2017.

Fees

39. Growers must pay the following subscription fees per Farm:

- $12,678 in year one;
- $10,003 in year two; and
- $3,300 in year three.

40. The Prospectus shows the following allocation of subscription fees:

Fee type	Year 1 30/6/1999	Year 2 30/6/2000	Year 3 30/6/2001
Management fee	$9,900	$9,900	$3,300
Licence fee	$100	$103	
Vines and trellises	$2,678		
Total	$12,678	$10,003	$3,300

41. Subsequent fees until 30 June 2017 will be as follows:

- **Management fees:** for year 4, the fee is calculated on a base fee of $1,800 at the end of the first year of the Management Agreement, which is deemed to increase at the end of years 1, 2 and 3 in accordance with the formula at clause 6.3. The annual fee for year 5 and onwards will be the fee of the previous year indexed by the CPI, in accordance with the formula in clause 6.3. Fees for year 4 and onwards will be payable from the gross income attributable to the Grower's Allotment. If the gross income is insufficient to pay the fees owing, the Manager may carry the fees forward until the subsequent year under clause 6.2(d). An incentive fee will also be payable if the Grower exceeds the Prospectus forecast. In this case the Grower will pay the Manager 50% of the excess, in accordance with the formula in Schedule 1 of the Management Agreement.
- **Licence fees:** the fee for each year is equal to the fee of the previous year indexed by the CPI, in accordance with the formula in clause 7.2. Fees for year 3 and onwards will be payable from the gross income attributable to the Grower's Allotment (clause 7.3(c)). If the income available is insufficient to pay the fees the Manager may carry the fees forward until a future year when there is sufficient money available to pay the fees (clause 7.3(d)).

Finance

42. Growers can fund their investment in the Project themselves, borrow from an independent lender or borrow through finance arrangements organised by the Manager.

43. Finance arrangements organised directly by a Grower with independent lenders will be a private arrangement between the Grower and the lender. Such arrangements are outside the arrangement to which this Ruling applies.

44. The Manager has engaged the services of Laton Securities Pty Ltd ('Laton'). Laton is not associated with the Manager or any associates of the Manager. Laton will arrange loans for Growers from two independent financiers, to cover the subscription fees payable to the Manager. Loans to Growers will have the following features:

- on the Grower being accepted as a borrower, the Manager will be put in funds directly as a result of the loan;
- the Manager will not put the funds received on deposit with Laton, or any of the financiers in question, or any associated persons, but will substantially use the funds, subject to the Trustee's approval, in carrying out its obligations under the Management Agreement;
- repayment of principal and payments of interest are not linked to derivation of income from the Project;
- loans made to investors are full recourse and there are no circumstances in which a Grower will not be required to repay the borrowed monies to the lender, within the period specified in the loan agreement;
- the lender will undertake normal commercial recovery activity, including legal proceedings where necessary, to recover borrowed monies from defaulting Growers;
- the Manager, Trustee or other entities associated with the Project will use the monies in operating the Project and will not place the Growers' subscription monies on security deposit or in substance return any of the funds to the lender (e.g., a round robin of cheques with some or all of the monies lent being returned to the lender); and
- Growers are not entitled to and will not recoup or have any part of their subscription monies refunded or returned after entering the Project.

45. Please note that the arrangement described in paragraphs 12 to 44 does not apply to Growers who:

- are subsequently relocated to a different farm (see paragraph 26);
- do not utilise the services of the Manager;
- elect to weed their own Allotment(s) (see paragraph 31);
- elect to have their vines harvested separately (see paragraph 31);

- elect to take the grapes attributable to their Allotment(s) for themselves (see paragraph 31); or
- organise finance agreements directly with lenders (see paragraph 43) or enter into finance agreements that do not have all of the features stated in paragraph 44.

Ruling

46. For a Grower who invests in the Project by 30 June 1999, the following deductions will be available for the years ended 30 June 1999 to 30 June 2001:

Expense type	ITAA 1997 Section	Deductions available each year		
		Year 1 30/6/1999	Year 2 30/6/2000	Year 3 30/6/2001
Management fee	8-1	$7,807	$9,900	$3,300
Licence fee	8-1	$100	$103	
Interest on loan	8-1	as incurred	as incurred	as incurred
Trellising	42-15		$91	$183
Landcare	387-55	$886		
Irrigation	387-125	$472	$472	$472
Horticultural plant expenditure	387-165			$138

Management fee

47. That part of the management fee that is capital or of a capital nature is not an allowable deduction. The deduction for management fees under section 8-1, as shown in the above table, has been calculated after taking out the capital element of this fee.

Licence fees

48. The licence fee paid by the Grower in relation to the Grower's Allotment is an allowable deduction (section 8-1).

Interest on loan

49. Interest incurred on loans arranged through Laton, of the kind described in paragraph 44, is deductible (section 8-1).

Trellising

50. Growers have the right to remove trellising and are entitled to claim a depreciation deduction for the cost of trellising, commencing on the date the trellising is installed (section 42-15). The Grower may elect to depreciate at 13% per annum under the 'prime cost method' or 20% or annum under the 'diminishing value method'. For illustration purposes, the figures in the table at paragraph 46 have been calculated using the prime cost method and an estimated date of installation of 31 December 1999. If the actual installation date of trellising is not 31 December 1999, the depreciation deduction will have to be calculated using the revised installation date (see paragraph 35).

Landcare

51. Landcare expenditures incurred by the Growers carrying on a vineyard business, as shown in the table, are deductible (section 387-55).

Irrigation

52. The Grower's capital expenditures on irrigation are deductible. The deductions can be claimed on the basis of one-third of the total expenditure in the year the expenditure is incurred, and one-third in each of the following two years of income (section 387-125).

Horticultural plant expenditure

53. A deduction for the establishment of grape vines will be allowable to the Grower at the rate of 13% per annum, calculated from the year in which a vine enters its first commercial season (section 387-165).

Section 82KL

54. Section 82KL does not apply to deny the Grower's deductions otherwise allowable under section 8-1.

Section 82KZM

55. The expenditure by Growers does not fall within the scope of section 82KZM.

Part IVA

56. Part IVA does not apply to deny a deduction for the expenditure by Growers, or interest on any loans covered by this Ruling that are taken out to fund payment of their expenditure.

Explanations

Section 8-1: management and licence fees

57. Consideration of whether the prepaid management and licence fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where a taxpayer merely 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 the second limb applies.

Is the Grower carrying on a business?

58. Vineyard activities can constitute the carrying on of a business. 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 proceeds from the sale of grapes will constitute gross 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 grape vines and the harvesting of the grapes for sale.

59. A Grower will be considered to be carrying on a business of a vineyard where:

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes produced;

- the vineyard activities are carried out the Grower's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, point to them carrying on a business.

An identifiable interest and right to harvest and sell grapes produced

60. By virtue of the Farm Allotment Agreement and the Management Agreement, the Grower has an occupancy right over an identifiable 0.25 hectare area of land growing 560 vines. There is a means to identify vines in which the Grower has an interest. The Grower has the right to use the Allotment for vineyard purposes and to have the Manager come onto the land to carry out its obligations under the Management Agreement. The Manager's obligations include harvesting and selling the grapes produced from the Grower's vines.

Vineyard activities carried out on the Grower's behalf

61. Under the Management Agreement, Growers appoint TAVPL, as Manager, to provide services such as preplanting and planting of grape vines, the installation of trellising and irrigation, and all other activities necessary to develop a mature fruit bearing vine.

62. The Grower's degree of control over TAVPL, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the general terms of the Project, Growers are entitled to receive regular progress reports on TAVPL's activities. Growers are able to terminate arrangements with TAVPL in certain instances, such as cases of default. The viticulture activities described in the Farm Allotment Agreement and Management Agreement are carried out on the Growers' behalf. From the information provided, a Grower controls its investment in the Project.

General indicators of business

63. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description in this Ruling for all these indicators. The independent Viticultural Report in the Prospectus considers the Project is feasible and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to cash flow projections contained in the Prospectus 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.

64. Growers will engage the professional services of a Manager, which holds itself out as having the appropriate credentials. The services are based on accepted viticultural practices and are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses.

65. Growers have a continuing interest in the vines from the time they are acquired until the end of the Project. There is a means to identify vines in which the Growers have an interest. 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.

66. By weighing up all of the attributes 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. 'Business operations' in this context, means such things as surveying of the land, installation of the trellising and irrigation items, and other preplanting work, all conducted as part of a coordinated and concerted plan to grow and harvest grapes for sale at a profit.

Apportionment of management fees

67. The activities the Manager is required to undertake are listed in the Management Agreement between the Grower and the Manager (see summary at paragraphs 28 to 34). Some of these activities are of a capital nature. The Manager's breakdown of subscription fees table at paragraph 40 outlines how the Grower's subscription monies will be spent. These monies, which principally consist of a management fee, will be spent on items that are of a revenue nature, while other expenditure is more properly classified as capital.

68. Under the Management Agreement the management fee is an undissected lump sum in return for which the Grower obtains services of both a revenue and capital nature. *Ronpibon Tin v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431 provides authority for the apportionment of the management fee in determining deductibility under section 8-1.

69. The joint judgment of the High Court in *Ronpibon Tin* stated that subsection 51(1) of the ITAA 1936 'contemplates apportionment' and 'there are at least two kinds of expenditure which require apportionment'. One of the described kinds of apportionable expenditure is a 'single outlay or charge which serves both objects indifferently', those objects being previously described as 'expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income

and distinct or severable parts to some other cause' (CLR at 59; ATD at 437). The management fee paid by the Grower is an example of such an expenditure.

70. The management fee paid by the Grower is for activities that are of a revenue and capital nature and, in accordance with paragraph 8-1(2)(a), the management fee is not an allowable deduction to the extent it is a loss or outgoing of capital or of a capital nature.

71. For the purpose of determining the extent to which the management fee is capital or capital in nature, the projected expenditure components of the management fee have been examined and characterised as either revenue (e.g., vine training and pruning, grape harvesting), capital (e.g., vine purchase costs, irrigation equipment), indirect expenses (fund raising expenses, income tax) or profit. The following formula has then been applied to determine the percentage that indirect costs and profit bear to direct revenue and capital expenses:

$$\frac{\text{Total projected overheads (indirect expenses) plus profit}}{\text{Total projected direct expenses}} \times \frac{100}{1}$$

72. The resulting percentage is a 'mark-up' figure that is applied to all direct revenue and capital costs. By applying the mark-up figure to all direct costs, all indirect costs and profits will be absorbed in the costs that more directly advantage the investor, ensuring that the entire sum of prepaid management fees are referable to one advantage or another.

73. The revenue component of the management fee after the mark-up is the relevant deduction for management fees under section 8-1. Expenditures that are acceptable as being incurred for the purposes of section 42-15 and Subdivisions 387-A, 387-B and 387-C, are increased to account for the mark-up percentage based on the calculations described above. The resulting deductions are shown in the table at paragraph 46.

Section 8-1: interest deductibility

74. Some Growers intend to finance the investment through a loan facility. The interest fees incurred will be in respect of a loan to finance the establishment of the vineyard, and its development in the first three years of the Project. These fees will, thus, also have a sufficient connection with the gaining of assessable income in later years. No capital, private or domestic component is identifiable in respect of them.

Section 42-15: trellising expenditure

75. Growers accepted into the Project incur expenditure on the trellising on which the vines are grown and is to be used on the grower's behalf in the operation of the vineyard business. Trellising is attached to the land as a fixture. This expenditure is of a capital nature.

76. Trellising is plant for the purposes of section 42-18. Under section 42-15 taxpayers can claim a deduction for depreciation on an item of plant used for the purposes of producing assessable income where they are the owners or quasi-owners 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, and absolutely, owned by the owner of the land.

77. However, it is accepted in certain circumstances that lessees are entitled to claim depreciation where they are considered to be the owners of those improvements. Taxation Ruling IT 175 sets out the ATO's views on this issue. Where lessees are considered to own the improvements under a state law 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. A deduction for depreciation is allowable on plant from the date it is installed and ready for use.

78. Growers accepted into the Project enter into a Farm Allotment Agreement to occupy certain land upon which they are entitled to grow vines to conduct a business of a vineyard. Under the Farm Allotment Agreement, the Grower has a right to remove the trellising at the end of the Project. The Grower's expenditure attributable to the acquisition and installation of trellising on the land has been identified as $1,407.

79. The cost of trellising will be eligible for a depreciation deduction by the Grower under section 42-15 at a rate of 13% prime cost or 20% diminishing value. The deduction commences at the date on which the trellising is installed and begins to be used for the purpose of producing assessable income. The Manager anticipates this date will be 31 December 1999. The Manager has given an undertaking to the ATO to advise Growers in the event that the actual date of installation differs from the anticipated date. In this case, the deduction specified in the table at paragraph 46 will need to be recalculated based on the actual date of installation.

Subdivision 387-A: landcare expenditure

80. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100%

deduction in the year in which the expenditure is incurred, under Subdivision 387-A. The expenditure that qualifies includes the eradication of animal and vegetable pests and other measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (section 387-60).

81. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer incurring such expenditure need not be the owner of the land so long as it is used at the time for carrying on a primary production business. In this case there will generally be no delay between the signing of the Agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time the expenditure was incurred. The necessary requirements under Subdivision 387-A will, thus, have been met in this respect.

82. The relevant expenditure attributable to eligible landcare measures for the purposes of sections 387-55 and 387-60 has been identified as $886. A deduction for this amount will be allowed in the year in which a participant enters into contractual arrangements with the Manager and commences to carry on a business of primary production. 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 for $886 will be allowable in that year.

Subdivision 387-B: irrigation expenditure

83. 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 by this Project would be covered by Subdivision 387-B.

84. A taxpayer who is a lessee or licensee of land and who is conducting a primary production business on the land may qualify for a deduction under Subdivision 387-B. A deduction will be available to the Growers in this Project at a rate of 33.3% per annum (with no pro rating required) for the cost of the irrigation system.

85. The expenditure identified as applicable to the conserving or conveying of water for the vineyards that meets the requirements of section 387-130 amounts to $1,416. 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 $472 per year.

Subdivision 387-C: horticultural plant expenditure

86. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grape vines. 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.

87. Horticultural establishment expenditure 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. The Grower's cost of vine establishment has been identified as $1,062.

88. The rate of the write-off will be 13% per year on a prime cost basis, assuming the effective life of the vines is greater than 13 but less than 30 years (section 387-185).

89. The write-off commences from the date the vines are used or held ready for use for the purpose of producing assessable income in a horticultural business (sections 387-165 and 387-170). The Manager anticipates the vines will enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business on 1 July 2000. The Grower's cost of vine establishment will be eligible for write-off deductions at a rate of 13% from this date.

90. The Manager has given an undertaking to the ATO to advise Growers in the event that the actual date of commencement of the first commercial season differs from that anticipated. In this case, the deduction specified at the table at paragraph 46 will need to be recalculated based on the actual date on which the first commercial season commences.

Section 82KZM: prepaid expenses

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

92. Under the Management Agreement a fee of $9,900 will be incurred on execution of that Agreement to undertake preplanting, planting and post planting services for the first year. In addition, a management fee of $9,900 is payable in year two and $3,300 in year three. In each instance the fees are charged for providing services to a Grower only for the period of 12 months from the time they are incurred. The fees are expressly stated to be for a number of specified services. In effect, the Manager is promising to provide significantly more services, in terms of value, in the first two years of the Project than in year three onwards.

93. For the purposes of this Ruling, no explicit conclusion can be drawn from the description of the arrangement to infer that the fees in the first three years have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fees could 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 management fees in years one, two and three is for doing 'things' that are not to be wholly done within 13 months of each fee being incurred.

94. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure incurred by Growers in respect of the financial years ended 30 June 1999 to 30 June 2001.

Section 82KL: recouped expenditure

95. 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'.

96. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit 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.

97. Section 82KZL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this

Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA: general tax avoidance provisions

98. For Part IVA 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).

99. The Terra Australis Vineyard Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 46, that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

100. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of grapes. There are no facts that would suggest that Participants have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Detailed contents list

101. Below is a detailed contents list for this Ruling:

Commissioner of Taxation
9 June 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA1936 51(1)
- ITAA1936 82KH(1)
- ITAA1936 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 177D(b)
- ITAA1997 6-5
- ITAA1997 8-1
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- ITAA1997 42-15
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- ITAA1997 Subdiv 387-A
- ITAA1997 387-55
- ITAA1997 387-60
- ITAA1997 Subdiv 387-B
- ITAA1997 387-125
- ITAA1997 387-130
- ITAA1997 Subdiv 387-C
- ITAA1997 387-165
- ITAA1997 387-170(3)
- ITAA1997 387-185
- ITAA1997 995-1(1)

Case references:

- *Ronpibon Tin v FC of T*
  78 CLR 47: (1949) 8 ATD 431

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