PR 1999/61 - Income tax: Coonawarra Premium Vineyards Project

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Product Ruling
Income tax: Coonawarra Premium 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.*
*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

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 Coonawarra Premium Vineyards Project, or 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are sections 6-5, 8-1, 42-15, 70-35, 387-55, 387-125, 387-165 and 387-355 of the *Income Tax Assessment Act 1997* ('ITAA 1997'), and sections 82KL, 82KZM and 97, and the relevant provisions of 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, as further qualified in paragraphs 17 and 19 below. 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 34) 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 16 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 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 2002. 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. This description incorporates the following documents:

- Draft Prospectus prepared for the Coonawarra Premium Vineyards Project, provided on 7 June 1999;
- Draft copy of **Constitution** prepared for the Coonawarra Premium Vineyards Project, undated, between Coonawarra Premium Vineyards Ltd (CPVL) as the Responsible Entity and each Grower, provided on 8 June 1999;
- Draft Copy of **Trust Deed** for The Coonawarra Premium Vineyards Unit Trust, undated, between Founder and CPVL as the Trustee, provided 8 June 1999;
- Custody Agreement between CPVL and Cardinal Financial Securities Limited ('CFSL'), undated;
- Draft Management Agreement between CPVL and Coonawarra Vineyard Management Services Pty Ltd ('CVMS') provided on 7 June 1999;

- one Grape Sale Agreement signed 21 April 1999 and three unsigned Draft Grape Sale Agreements, provided with the Product Ruling Application;
- one bound set of Land Purchase Agreements, comprising:
- Contract to purchase land described as Section 61 in the Hundred of Comaum (81.44 hectares), unsigned;
- Option to purchase land described as Section 60 in the Hundred of Comaum (36.83 hectares), signed 14 January 1999;
- Option to purchase land described as Sections 58 and 59 in the Hundred of Comaum (82.55 hectares), signed 9 April 1999;
- Option to purchase land described as Sections 64 and 65 in the Hundred of Comaum (42.19 hectares), signed 9 April 1999;
- Land Valuation Report dated 22 April 1999;
- Soil Analysis Report signed but undated; and
- letters and facsimile transmissions from Applicant dated 25 May, 31 May 1999, 1 June 1999 (2), 2 June 1999, 4 June 1999, 7 June 1999 (2) and 8 June 1999.

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

13. The documents highlighted are those Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate[1] of a Grower, will be a party to, which are part of the arrangement to which this Ruling applies, except agreements that come within paragraph 32 below, concerning the provision of finance. The effect of the agreements listed above is summarised as follows.

14. This arrangement is called the Coonawarra Premium Vineyards Project . The Responsible Entity, CPVL, proposes to offer 2,800 Investment Units. The Investment Units will be 'stapled' units, comprising 1 Grower Unit and 1 Unit in The Coonawarra Premium Vineyards Unit Trust.

15. CPVL, as trustee of this trust, has contracted to acquire 81 hectares of land in the Coonawarra region of South Australia, and has acquired options to acquire other land in the region. There are

[1] In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936.

4 stages of vineyard development comprised in the offer to investors through the current Prospectus. The total area of land available for planting in all four stages is 243 hectares, of which 226 hectares has been identified as being suitable for planting. It is anticipated that approximately 158 grapevines will be planted on each vineyard, and that if all Investment Units to be offered are taken up, approximately 442,400 grapevines will be planted.

16. Participants in the Project become bound by the terms of the Constitution, by executing an application in which they agree to be bound by its terms (cls 1.2 and 2.1[2]). On CPVL entering their name in the Project Register, they become accepted as a Grower for the purposes of this Ruling.

17. There is a maximum of 955 vineyards on offer to Investors under the first stage, with the total land available in this stage for planting being 81 hectares. There is no formal level for minimum subscription but the Project shall not commence until the Directors of CPVL are satisfied the company has sufficient financial resources to meet ongoing scheme related cash requirements for a minimum of three months. Only after this occurs can the Grower's name be entered into the Project Register. **This Ruling only applies to Growers whose names are entered in the Project Register.**

Interests applied for

18. All persons applying to participate in the Project must apply for a stapled Unit, consisting of a Unit in The Coonawarra Premium Vineyards Unit Trust , and a Grower Unit. However, they have the choice of whether the Unit in the Unit Trust is to be held by them, or an associated party. They also have the choice of whether or not the Grower Unit is to be a Managed Grower Unit (cl 29.1). Both the unmanaged Grower Unit and the Managed Grower Unit entitle the holder to use a specified area of land (their 'Vineyard Lot') to carry on a business of growing grapevines and harvesting and selling any resulting grapes (cls 19 to 31). Under clause 19.4, property in the harvested grapes passes to the Grower at the time of harvest.

19. However, the Managed Grower Unit also involves appointing CPVL as the Grower's agent to carry on this business. The rest of this description of the arrangement only covers Growers who acquire Managed Grower Units. **Therefore, this Ruling will not apply to persons who enter the Project but choose not to use the services of CPVL**.

[2] In this Ruling all references to clauses are to clauses in the Constitution, unless otherwise stated.

20. To be accepted into the Project each Grower will be required initially to contribute $8,500, payable in four payments as follows:

- $6,486 payable on lodging application;
- $671 payable on invoice, by 30 June 2000;
- $662 payable on invoice, by 30 June 2001;
- $681 payable on invoice, by 30 June 2002 (cl 12).

The Constitution

Management conditions

21. There is no separate Management Agreement for this Project. Instead, the terms under which CPVL is to provide management services to the Growers holding Managed Grower Units are set out in clauses 32 to 38 of the Constitution. In fact, the Constitution is intended to set out in full the legal relationships between a Grower and CPVL, on acceptance of the Grower into the Project.

22. Where the Grower appoints CPVL, they enter into a management arrangement with that company for the period to 31 December in the 13th year following the Allocation of the Vineyard Lot (cl 32). CPVL is responsible for the establishment of a vineyard on their behalf, the ongoing maintenance of those vines, the harvesting of grapes from those vines, and the marketing and selling of the grapes. The Grower and, therefore, CPVL as their agent, must plant no less than 155 grapevines, of only specific varieties, on each Vineyard Lot (cls 28 and 29).

23. CPVL may subcontract its obligations under this arrangement to another party, and proposes to contract with Coonawarra Vineyard Management Services Pty Ltd in this regard.

24. Under clause 34.1, CPVL will be responsible for maintaining records of the activities carried out on behalf of the Grower. The Grower may inspect these records at any time. CPVL is, under clause 34.2, to supply the following reports to each Grower at least once a year:

- the state of health of the grapevines;
- the expected crop levels;
- previous crop yield;
- revenue generated; and
- expenses incurred.

25. A Grower may terminate their agreement with CPVL in certain situations:

- where CPVL commits a breach of any of its obligations and the default is not remedied within 10 Business Days of receiving notice of the breach (cl 38.2); and
- where a meeting of members, complying with section 252J of the Corporations Law, passes a motion, by at least 50% of the total number of votes, to do so (cl 39.2).

26. Any trellises affixed to the land on behalf of a Grower will remain the property of the Grower (cl 19.5) and the Constitution grants the Grower the right to remove these trellises at the end of the Project.

27. Each Grower's name will be entered in a Growers' Register. Each Grower's name will be matched with a 'uniquely identified' Vineyard Lot (cl 13.5) of approximately 0.08 hectares, and they will be advised of the exact location of this by reference to the 'GRO' plan lodged with the South Australian Land Titles Office.

Fees payable and work to be performed

28. Under clause 12.2, application fees payable in relation to each Managed Grower Unit in respect of the first Issue (the first allocation of Grapevines) are

- $654 per Trust Unit;
- $7,846 per Managed Grower Unit, which is comprised as follows:
- $132 for Landcare Works that fall within the definition of 'landcare operations' in section 387-60;
- $181 for the purchase of grapevine rootlings;
- $98 for planting the Grapevines;
- $800 for the purchase and installation of Trellising;
- $25 for Building Infrastructure, representing the Member's fractional interest in buildings;
- $1,245 for Irrigation works, including the purchase and installation of irrigation, bores, pumps, frost control and other similar irrigation. All of this expenditure is limited to activities set out in Subdivision 387-B;
- $82 for connecting power to the land, as defined in section 387-360;
- $2,901 Management Fee for general farm maintenance and management of the Vineyard Lot. This particular

amount is payable by 30 June 1999 and covers the period 1 July 1999 to 30 June 2000;

- $646 **Management Fee** – as above, but payable by 30 June 2000 for management services provided during the period 1 July 2000 to 30 June 2001;
- $662 **Management Fee** – as above, but payable by 30 June 2001 for management services provided during the period 1 July 2001 to 30 June 2002;
- $681 **Management Fee** – as above, but payable by 30 June 2002 for management services provided during the period 1 July 2002 to 30 June 2003; and
- $393 **Grant of Use Fee**[3] – payment of 3 years licence fee (at $131 per year) up to, and including the year ended 30 June 2002.

29. After the initial application fees of $8,500 have been applied in the above manner, fees payable in subsequent years (as set out in cls 20 and 35) are to be met, in the first instance, from the Grower's proceeds from sale of grapes (cl 36.3.1). However, to the extent that the annual management fee and/or Grant of Use fee cannot be discharged in this manner, Growers will continue to be liable personally for any balance owing to CPVL.

30. Growers may also be made personally liable to contribute additional amounts of capital in respect of their Unit in the Unit Trust, under clause 4.5.1 of the Trust Deed.

31. Liability for the $6,486 payable on application does not become a presently existing liability until such time as a Grower completes and lodges their application form and CPVL issues the appropriate interests. Invoices will be rendered for the additional amounts of $671, $662 and $681 in the years ended 30 June 2000, 2001 and 2002, respectively. Presently existing liabilities for these amounts will arise at the time that the invoices are raised.

Finance

32. There are no funding arrangements to be offered by CPVL or any associated entity, in connection with this Project. Growers may use their own funds, or arrange finance from an independent lender. Loan transactions to which this Ruling applies will exhibit the following features:

- all loan terms will be of an arm's length nature;

[3] Under cl 20.1 this fee is payable to CPVL in its capacity as trustee of The Coonawarra Premium Vineyards Trust.

- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full 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 agreement, to reduce the borrower's liability; and
- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about, the time of the making of the loan.

Derivation of income

33. Growers with Managed Grower Units appoint CPVL to be their exclusive agent to market and sell the grapes produced (cl 32).

34. CPVL may, at its discretion, mix all or some of the grapes from each Grower's managed vineyard lots for subsequent sale (cl 32.7). CPVL may also reject and dispose of any grapes which it deems unsuitable for the production of wine (cl 32.8).

35. Growers will be entitled to the proceeds from the sale of the grapes without reference to type, quality or volume. However, sale proceeds will be derived by each Grower based on the number of Grower Units held (cl 32.10). Possible projected returns for Growers are provided in Section 6 of the draft Prospectus. They depend on a range of assumptions and CPVL does not give any assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with entering into the Constitution and associated agreements. However, based on the financial model prepared for the Project, CPVL indicates that Growers gearing their investment by 60% and acquiring their Trust Unit through their superannuation fund can expect to achieve an internal rate of return before tax of approximately 13.4% and an internal rate of return after tax of approximately 25.8%. The Prospectus also indicates that if the investment was made totally by cash, the expected pre-tax internal rate of return would be approximately 12% and the expected after tax internal rate of return would be 12.5%.

Ruling

Sections 8-1, 42-15, 387-55, 387-125, 387-165 and 387-355

36. For a Grower who enters the Project by 30 June 1999 and who incurs the fees set out in paragraph 28 because they choose to engage CPVL, deductions will be allowable to them in respect of each Managed Grower Unit for the years ended 30 June 1999 to 30 June 2002, as set out in the following table:

Fee type (tax law applicable)	**Year ended 30 June 1999**	**Year ended 30 June 2000**	**Year ended 30 June 2001**	**Year ended 30 June 2002**
Licence Fees (8-1)	- (see Note (i))	$131 (see Note (i))	$131 (see Note (i))	$131 (see Note (i))
Management Fees (8-1)	$1,670	$646	$662	$681
Trellis (42-15) Cost allocated in Constitution: $800 Management fee allocation: $205	-	$87 (see Note (ii))	$131	$131
Landcare (387-55) Cost allocated in Constitution: $132 Management fee allocation: $513	$645	-	-	-
Irrigation (387-125) Cost allocated in Constitution: $1245 Management fee allocation: $308	$518 ($^1/_3$ each year)	$518	$518	-
Vines and Planting (387-165) Cost allocated in Constitution: $279 Management fee allocation: $205	-	-	-	$55 (see Note (iii))
Electricity connection (387-355)	$8 ($^1/_{10}$ for 10 years)	$8	$8	$8

Notes:

(i) CPMV anticipates that most Growers will invest in multiple interests and the amounts in the table have been calculated on the assumption that the Grower obtains a minimum of 3 Managed Grower units. The licence fee amount of $393 for the first three years of the Project is incurred at the time the Grower is accepted into the Project, and is for the doing of a thing not to be wholly done within 13 months after this time. For Growers who purchase 3 or more units, the amount of expenditure incurred exceeds $1,000 and is not 'excepted expenditure' for the purpose of section 82KZM. Deductions for the $393 licence fee would, therefore, only be allowable according to the formula in section 82KZM, as shown in the table.

However if a Grower acquires less than 3 Units, the expenditure incurred would be 'excluded expenditure' (i.e., < $1,000- refer to subparagraph 82KZM(1)(b)(ii)) and the $393 licence fee included in the initial

contribution would be fully deductible under section 8-1 in the year ending 30 June 1999.

(ii) Deductions for depreciation under section 42-15 for the income years shown will depend on the number of days the plant is owned and installed ready for use. CPVL is to advise Growers of this. Growers will need to choose which depreciation method they use (section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method'). The figures shown in the table are, therefore, included for illustrative purposes only and are subject to change. The deductions shown are based on the Trellis being installed ready for use on 1 November 1999 and the application of the 'Prime cost method'.

(iii) Deductibility under section 387-165, for horticultural plant establishment expenditure, will commence from the time that the grapevines, as horticultural plants, enter their first commercial season. CPVL will advise Growers of this, but anticipate the vines will enter their first commercial season in September 2001. CPVL considers a Grower will be able to determine, for the purposes of section 387-175, that the trees have an 'effective life' for the purposes of section 387-185 of less than 30 years, resulting in a write-off rate of 13%. For the purposes of illustration, the deductions shown in the table are based on a 13% write-off rate commencing from 31 August 2001.

37. For a Grower who enters into the Project after 30 June 1999, but before 30 June 2000, and who incurs the fees set out in paragraph 28, they will be entitled to the same deductions as set out in the table above, except:

- their deductions will not commence until the year ended 30 June 2000;
- their deduction for Management Fees in the year ended 30 June 2000 will be the combined amount of the first two payments of Management Fees; and
- their deductions for Irrigation, Landcare and Electricity Connection will all be 'moved forward' a year.

Division 35 – deferral of losses from non-commercial business activities

Section 35-55 – Commissioner's discretion

37.1. For a Grower who is an individual and who entered the Project on or after 16 June 1999 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2002 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

37.2. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies.

37.3. Where, either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, ie, any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

37.4. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

Section 82KZM

38. Some of the expenditure listed in the above table does fall within the scope of section 82KZM, as explained in Note (i) above.

Section 82KL

39. Section 82KL does not apply to deny the deductions otherwise allowable under section 8-1, as set out in the above table.

Part IVA

40. 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.

Section 6-5, section 97

41. Growers deriving gross proceeds from the sale of grapes must include these proceeds in their assessable income for the relevant year, under section 6-5. Growers presently entitled to income from The Coonawarra Premium Vineyards Unit Trust, who are not under a legal disability, must include the appropriate amount in their assessable income under section 97 of the ITAA 1936.

Section 70-35

42. Growers who have harvested grapes on hand at the end of any income year will be holding trading stock of a business carried on by them. The excess of the value of this trading stock at the end of any income year over the value of trading stock at the start of that income year must be included in their assessable income under section 70-35.

Explanations

Section 8-1

43. Consideration of whether the fees payable to CPVL 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 all that happens in a year of income is 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 outgoings in question have a sufficient connection with activities to produce assessable income.

44. An agriculture scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross proceeds from sale of the agricultural produce from the scheme will constitute assessable income in their own right. 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 agricultural crops, in this case, grapes, and sometimes processing of those crops, as in this case.

45. Generally, an investor will be carrying on a business of agriculture where:

- the investor has an identifiable interest in specific growing crops coupled with a right to harvest and sell the produce from those crops;

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

46. For this Project Growers have, under the Project Constitution, rights to farm an identifiable area of land consistent with the intention to carry on a business of growing grapes. Under the Constitution, Growers appoint CPVL to provide services such as planting, cultivating, tending, fertilising, spraying, watering, maintaining and otherwise caring for their Grapevines. Growers are considered to have control of their investment.

47. The Constitution gives Growers an interest in the grapes grown on their behalf and the right to have those grapes sold for their benefit. The Project documentation contemplates that Growers will have an ongoing interest in the growing crops. The crops belong to the Growers in the sense that they have an interest in the land on which they are growing and a profit à prendre in respect of the produce, which confers an equitable interest in the crops upon the Grower.

48. Growers have the right to use their Vineyard Lots for agricultural purposes and to have CPVL come onto the land to carry out its obligations under the Constitution. The Growers' degree of control over CPVL, as evidenced by the Constitution, and supplemented by Corporations Law, is sufficient. A majority of the Growers are able to terminate the arrangements with CPVL in certain instances, such as default in performance of its duties and failure to rectify the default. The agricultural activities described in the Constitution are therefore carried out on the Growers' behalf.

49. 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 for all the indicators discussed in that Ruling. 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, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

50. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which grapevines Growers have an interest in. These services are based on accepted agricultural practices and are of the type ordinarily found in farming ventures that would commonly be said to be businesses.

51. Growers have a continuing interest in the grapevines from the time they are acquired and planted on their behalf. The agricultural 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' agricultural activities will constitute the carrying on of a business.

52. The fees associated with the agricultural 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 the crop produce) is to be gained from this business. They will, thus, be deductible under section 8-1, except to the extent they are capital, or of a capital nature. Capital components of the fees have been separately identified in clause 12. Additional capital components have been identified in the initial Management Fee and have been recognised in the table in paragraph 36. No 'non-income producing purpose' in incurring the fees is identifiable from the arrangement. The tests of deductibility under section 8-1 are met. The exclusions in subsection 8-1(2) do not apply, other than in relation to the capital exceptions noted above.

Section 387-55

53. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on landcare operations for land used to carry on a primary production business.

54. Landcare operations for land include work on erecting fences primarily and principally for the purpose of excluding animals from an area affected by land degradation to prevent or limit extension of that degradation and to help reclaim the area. They also include work on constructing drainage works primarily and principally for the purpose of controlling salinity or assisting in drainage control, and work primarily and principally for the purpose of eradicating pests and plants detrimental to the land.

55. Growers need not own the land to qualify for the deduction, so long as it is to be used by them in carrying on a primary production business. In this Project there will be no delay between the execution of the relevant agreements and the commencement of 'business operations' on the Grower's behalf. Accordingly, a Grower's primary production business will have commenced at the time the expenditure in question has been incurred, and the requirements of section 387-55 will have been satisfied.

Section 387-125

56. Section 387-125 allows a deduction for capital expenditure on the construction, manufacture, installation or acquisition of a water facility, if incurred primarily and principally for the purpose of conserving or conveying water for use in a primary production business conducted on land in Australia.

57. The section allows this expenditure to be deducted over a 3 year period, i.e, at a rate of 33.3 per cent per annum, starting with the year in which the expenditure is incurred. The taxpayer to whom such deductions are allowable does not need to own the land in question. Irrigation works of the kind to be carried out for Growers in this Project by CPVL are of the type to which section 387-125 applies.

Section 387-165

58. Subdivision 387-C allows deductions in respect of capital expenditure on establishing horticultural plants for use in a horticultural business. For the purposes of this Subdivision, a lessee or licensee of land (such as the Growers in this Project) carrying on a business of horticulture, is treated as owning the plants growing on the land, rather than the actual owner. The deductions allowable under section 387-165 commence from the time the plants enter their first commercial season. CPVL will advise Growers of this event.

59. Horticultural plant establishment expenditure is capital expenditure on establishing the horticultural plants, and includes such things as the cost of acquiring the plants, costs of pre-planting and planting, such as ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure on draining swamps or the initial clearing of land.

Section 42-15

60. Under the Constitution CPVL will, on the Growers' behalf, acquire trellising to support the growing vines, and Growers have the right to remove these trellises. Under Taxation Ruling IT 175 these Growers will be considered to be the 'owners' of these items. These items will also be used for the purpose of producing assessable income from the time they are installed.

Section 387-355

61. A deduction is allowable under Subdivision 387-E for capital expenditure incurred by a person on 'connecting power to land or upgrading the connection' if the person has an interest in land, or is a share-farmer carrying on a business on the land, and they intend to use

all or some of the electricity to be supplied in carrying on a business on that land for the purpose of producing assessable income.

62. The deduction is calculated, under section 387-355, over a period of 10 years from the time the expenditure is incurred, i.e., you deduct 10% of the expenditure each year. Work that constitutes 'connecting power to land or upgrading the connection' is exhaustively defined in section 387-360. The work to be performed by CPVL, for which a fee of $82 is to be charged, meets the requirements of section 387-360.

63. Growers accepted into this Project will also have an 'interest in land' at the time of incurring the expenditure by virtue of their rights under the Constitution and their licence to use their Vineyard Lot.

Section 82KZM

64. The Grant of Use fee is incurred at the time the Grower is accepted into the Project and is for the doing of a thing not to be wholly done within 13 months. Section 82KZM will apply unless the expenditure is 'excluded expenditure'. If a Grower acquires 3 or more units, the amount of expenditure will exceed $1,000 and will not be 'excluded expenditure' as defined in section 82KZL. In this case, section 82KZM will apply to allow the deductions over the period to which the payment relates, according to the formula in that section. CPMV expects most Growers to acquire 3 or more units and the table in paragraph 36 has been constructed on this basis. However, Growers who obtain fewer than 3 Managed Grower Units will incur expenditure for Grant of Use of less than $1,000. In this case, the expenditure would be 'excluded expenditure', section 82KZM will not apply and the expenditure will be deductible in the year it is incurred.

65. Under the Constitution the fees for management services will be charged only for services to be provided within 13 months of incurring the relevant expenditure. The fees are for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that any of these fees have been inflated to result in reduced fees being payable for subsequent years. There is also 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 are for CPVL 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 is not satisfied and it will not apply to the expenditure on Management Fees for the first 4 years up until 30 June 2002.

Section 82KL

66. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. 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 to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

67. 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). The Project will be a 'scheme' commencing generally on the date the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deductions for the fees payable to CPVL, 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(s).

68. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the regular harvesting of the crops. Further, there are no features of the Project, for example, such as the fees being 'excessive', and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient 'real money' coming into the manager's or landowner's hands, that might suggest the Project was so 'tax driven', and so 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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Commissioner of Taxation
16 June 1999

Previous draft:

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Related Rulings/Determinations:

IT 175; PR 98/1; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; 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

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- ITAA1936 82KZL
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- ITAA1936 82KZM(1)(b)(ii)
- ITAA1936 97
- ITAA1936 Pt IVA
- ITAA1936 177A
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- ITAA1936 177D
- ITAA1997 6-5
- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
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