PR 1999/84 - Income tax: GlenKara Estate Vineyard Project

Product Ruling
Income tax: GlenKara Estate Vineyard Project

Contents Para

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 GlenKara Estate Vineyard Project, or just simply as 'the Project' or the 'product'.

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 of the ITAA 1997;
- section 42-15 of the ITAA 1997;
- section 387-55 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 387-165 of the ITAA 1997;
- section 387-355 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');

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

Class of persons

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it. Specifically, it does not include any persons who enter the Project but also exercise their rights under the Option Agreement to exit from the Project before its completion. Such persons may need to request private rulings on the tax consequences of such action.

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 38) 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.

8. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission

Date of effect

9. This Ruling applies prospectively from 23 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 28 April 1999;

- GlenKara Estate Vineyard Project Prospectus No 2 dated 22 April 1999;
- **GlenKara Estate Project Deed** between Pyrenees Vineyard Management Limited ('PVML', or 'the Manager'), Glensborough Estate Pty Ltd ('GESPL' or 'the Land Owner'), Sandhurst Trustees Limited ('STL'or 'the Representative') and each Grower, dated 23 May 1997, including two Supplemental Deeds;
- Draft **Development Agreement** between the Manager and each Grower;
- Draft **Management Agreement** between the Manager and each Grower;
- Draft **Vineyard Lease** between the Manager and each Grower;
- Draft **Option Agreement** between the Land Owner and each Grower;
- Improvements to Land Agreement between the Land Owner and the Manager dated 22 April 1999;
- Head Lease between the Land Owner and the Manager dated 22 April 1999;
- various Grape Purchase Agreements; and
- Correspondence and attachments received from Pyrenees Vineyard Management Ltd dated 9, 11, and 15 June 1999 and 15 January 2001.

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(within the meaning of section 318 of the ITAA 1936) of the Grower, will be a party to, with the exception of agreements concerning the provision of finance which come within paragraphs 34 to 37 below. The effect of these agreements is summarised as follows.

Overview

14. This arrangement is called the GlenKara Estates Vineyard Project. The Manager has established a vineyard on land situated in the Pyrenees region near Landsborough in central Victoria ('the Project Land'). The Manager has leased Stage 2 of the Project Land

from the Land Owner under the Head Lease. Growers entering into the Project will lease land (a 'Vineyard Allotment') from the Manager for a period of 20 years. The minimum individual holding is one leased area, being an allotment of 0.5 hectares with an average of 1,020 vines (page 3, Prospectus). Overall, it is proposed to plant 120 hectares represented by 240 separate allotments.

15. The minimum subscription under this Project is 40 A2 Class Vineyard Allotments (cl 6.3 of the supplementary deed dated 1 April 1999 and page 4 of the Prospectus). This Ruling will not apply if the minimum subscription is not reached. The Manager reserves the right to accept oversubscriptions of a further 120 Vineyard Allotments.

16. Growers will lease land from the Manager. Growers will also enter into two agreements with the Manager for such work as 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. Each Grower also appoints the Manager to harvest and sell the Grower's grapes each year.

Development Agreement

17. The Growers will engage the Manager under the Development Agreement to carry out the Development Works in respect of their vineyard allotment, in consideration of incurring the Development Fee. All this work is to be completed within 13 months of the date on which this fee is incurred.

18. The Development Works include design of the layout of the vineyard, acquiring and installing an irrigation system, arranging a suitable electricity supply, preliminary soil analysis and fertilising, supplying and erecting trellising, and selecting and planting appropriate grapevine rootlings.

19. All plant, equipment and other property acquired on behalf of a Grower for installation on their allotment, including, but not limited to, posts, trellises and vine rootlings, is to be the property of the Grower.

20. The Development Fee of $13,550 per 0.5 hectare allotment is payable on acceptance of the Grower into the Project, and is dissected in 'Annexure A' of the agreement, into the following components:

- purchase and planting of vine rootlings $4,565
- purchase and installation of trellising $4,000
- purchase and installation of irrigation $4,035
- connection of mains electricity $200

- landcare operations $750.

21. The expenditures on the following items meet the respective requirements for expenditure on the relevant work, as set out in the following provisions:

- purchase and planting of vine rootlings: horticultural plant establishment work, for the purposes of section 387-165, ITAA 1997;
- purchase and installation of trellising: acquiring and installing a unit of plant, for the purposes of section 42-15, ITAA 1997;
- purchase and installation of irrigation items: acquiring and installing water facilities, for the purposes of section 387-125, ITAA 1997;
- connection of mains electricity: connecting power to land, for the purposes of section 387-355, ITAA 1997; and
- landcare operations: landcare operations as defined in section 387-60, ITAA 1997.

Management Agreement

22. Under the Management Agreement the Grower appoints the Manager to provide the Vineyard Services, being services to be carried out once the vines have been planted, including:

- the cultivation, maintenance and management of the vineyard in accordance with the Management Plan (cl 5.1); and
- the harvesting and selling of the grapes, including testing grape maturity, determining the commencement date of harvesting, arranging appropriate time for collection and loading grapes for delivery to purchasers (cl 5.2).

23. Grapes harvested by the Manager from each Vineyard Allotment will be pooled with the grapes produced by other Growers participating in Stage 2 of the Project, with the gross proceeds from the sale of these grapes being shared amongst the Growers in accordance with the Project Deed (cl 5.6(b)). Each Grower will own all the Improvements on their Vineyard Allotment, including all of the vines and grapes (cl 6.1).

24. Management fees will be paid by the Grower to the Manager annually in advance on or before 30 June of the preceding financial year, (cl 10.1 and Item 4 of the Schedule to the Agreement) as set out

overleaf. After the fourth financial year, Management Fees are to be paid out of the proceeds of the venture. The Manager has stated that he will utilise the recovery powers available to him at clause 9.3 of the Project Deed to recover any Management Fees outstanding.

Payment Date- 30 June	**Management Fee per 0.5 ha**
1999	$10,050
2000	$3,650
2001	$3,300
2002	$2,850
2003 and subsequent years	$2,350 indexed + Harvest Fee and Success Fee

25. A Harvest Fee, as specified in the Schedule to the Management Agreement, of $200 per tonne, indexed from 1 July 2002, is also payable to the Manager, and will be deducted from the gross sale proceeds. The Grower must also pay to the Manager a Success Fee equal to 10% of the amount by which the grape sale price exceeds $1,750 per tonne, also indexed, from 1 July 2000.

26. The Manager will maintain insurance policies on behalf of the Growers (cl 8.1) and will pay on behalf of a Grower all stamp duty payable on the lease under the Management Agreement (cl 22.4). Growers will be required to meet any GST or similar taxes.

27. The Manager is required to produce an annual Management Plan (cl 11), and prepare a Yearly Report for Growers (cl 13). The Grower is entitled to have access to their Vineyard Allotment, to inspect and monitor the performance of the Manager (cl 9.2). The Grower also has the right to issue directions and make recommendations to the Manager in respect of the performance by the Manager of the Vineyard Services (cl 5.7).

28. The Grower may terminate the Management Agreement in the event that the Manager defaults in performance of any obligation owed to the Grower under the agreement (cl 15). Growers together may pass a special resolution (with 50% of the Growers voting in favour), to replace the Manager as manager of the Project (cl 18.2).

Vineyard Lease

29. Under the Vineyard Lease the Manager will lease to the Grower the Grower's Vineyard Allotment and, together with other Growers, the Common area, for a period of 20 years (cl 2.1 and Item 4 of the Schedule). This lease will give each Grower the right to develop their Vineyard Allotment into an operational vineyard. The Grower will be the owner of the Grower's Improvements (cl 8.2) and

will have the right to harvest and take as their own, any Grapes during the term of the lease.

30. The Grower must pay to the Manager an annual rent in advance on 30 June of each financial year (cl 4). The rental to be paid by the Grower during the first 4 years of the Project will be $150 per annum. From year 5 this amount will be increased by 5% per annum or the CPI index (whichever is the higher).

Head Lease and Improvements to Land Agreement

31. The Land Owner is the registered proprietor of the Project Land. Under the Head Lease the Land Owner will lease the Project Land to the Manager, to be used for the purpose of carrying out the Project, for a term of 20 years. Under the Improvements to Land Agreement the Land Owner is to undertake certain improvements to the common area of the Project Land prior to 30 June 1999, in expectation that the minimum number of Grower Subscriptions required under Prospectus No 2 will be received by the Manager on or before that date. The works to be carried out include 2 dams.

Option Agreement

32. Under the Option Agreement the Land Owner grants an option (‘the Reversion Option’) to the Grower to sell the Grower’s Improvements to the Land Owner at any time from Year 9 of the term prior to the expiration of the Lease for the Reversion Fee. If the Reversion Option is not exercised, the Grower also has an Option (‘the Improvements Option’), exercisable after the Vineyard Lease expires, to sell the Grower’s Improvements to the Land Owner for the Improvements Fee.

33. Grower’s Improvements are defined in clause 1.1(f) to mean all the plant, equipment and other property acquired by the Grower, or on behalf of the Grower, to be installed, or which has been installed, on the Vineyard Allotment, and includes, without limitation, the posts, trellises, irrigation equipment and vines. Where the Improvements Option is not exercised the Grower has the right under clause 9 to remove all of the Grower’s Improvements, subject to satisfying the conditions set out in clause 9.2.

Finance

34. Medco Financial Services Pty Ltd (‘MFPL’), a company associated with the Manager, will provide Growers with the opportunity to fund their investment in the Project. Alternatively, Growers may seek to finance their investment from other lenders. Finance arrangements organised directly by a Grower with

independent lenders are outside the arrangement to which this Ruling applies.

35. MFPL will carry out its own credit assessment of potential borrowers and make a decision whether or not to enter into a Loan Agreement with each person. There is no other agreement, or arrangement, between MFPL and the Manager in relation to any guarantee of repayment of the loan or otherwise. The Manager will not provide any security for the loans made by MFPL and will not deposit, either directly or indirectly, any loan funds received from a Grower, back with MFPL.

36. The Loan Agreement with MFPL will result in a Loan Facility with draw downs timed to match the actual Subscription and Management Fee payments up to $34,000. Interest is fixed at 10.5% per annum for the term of the loan, which is 10 years. Interest will be charged monthly and an application fee of $275 will also apply.

37. The loan to be made by MFPL will be made on normal commercial terms and conditions, and MFPL will have full recourse to assets of the Grower. As security the Grower may be required to provide a personal guarantee. Loan repayments will be deducted from grape sale proceeds initially. However, if the crop fails, or the proceeds are otherwise insufficient, Growers are required to make payments directly to MFPL.

Derivation of income

38. The first harvest from Stage 2 is expected in the year ending 30 June 2002, with the first full crop expected to be harvested in the year ending 30 June 2004. The harvested crops will be sold to various wine producing companies under the Grape Sale Agreements. The prices to be paid will vary according to the quality of the grapes and the prevailing market prices. Revenues will be calculated in total for all the Growers participating in the Project and then pooled. The pooled proceeds will be evenly allocated to Growers, based on the number of Vineyard Allotments held, irrespective of which of the purchasers acquires a particular Grower's crop.

39. Whilst the crop has been pre-sold under the Grape Sale Agreements, yields and quality are uncertain. Thus, there are no guaranteed returns to investors. However, based on the Manager's projections contained in the Prospectus, Growers can anticipate that their gross proceeds from the sale of grapes over the life of the Project will exceed their total expenses.

Ruling

40. For a Grower who invests in the GlenKara Estate Vineyard Project by 30 June 1999, and who utilises the services of the Manager and incurs the fees set out in paragraphs 20, 24 and 30, the following deductions will be available for the years ended 30 June 1999 to 30 June 2001:

Fee type	Deductions available each year		
	Year 1	**Year 2**	**Year 3**
	30/6/1999	**30/6/2000**	**30/6/2001**
Management fee (see note (a))	$10,050	$3,650	$3,300
Vineyard Rent (note (b))	$150	$150	$150
Irrigation (note (c))	$1,345	$1,345	$1,345
Preplanting and planting of Vines (note (d))	--------	--------	--------
Trellising (note (e))		$520	$520
Landcare Operations (note (f))	$750	--------	--------
Electricity Connection Expenses (note (g))	--------	$20	$20

Notes:

(a) management fees paid for the services outlined in the Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1);

(b) rent paid by the Grower in relation to the leased area will be an allowable deduction in the year incurred (section 8-1);

(c) 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);

(d) a deduction for vine establishment expenditure will be allowable, at a rate of 13% per annum, commencing from the time that the vines enter their first commercial season, which is expected to be in the income year ending 30 June 2002 (section 387-165);

(e) 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, commencing from the time that the trellising is first used for the purpose of producing assessable income (for illustrative purposes depreciation has been allowed using the prime cost method);

(f) expenditure on landcare operations will be an allowable deduction wholly in the year incurred (section 387-55); and

(g) expenditure on connecting electricity will be an allowable deduction at the rate of 10% per annum commencing in the year the expenditure is incurred (section 387-355).

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

Section 35-55 – Commissioner's discretion

40.1. For a Grower who is an individual and who entered the Project on or after 23 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 2003 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.

40.2. 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.

40.3. 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, i.e., 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.

40.4. 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.

41. Interest incurred by a Grower in relation to money borrowed from MFPL to fund their investment in the Project will be an allowable deduction for the year of income in which it is incurred. Interest expenditure will first be incurred in the income year ending 30 June 2000.

Sections 82KZM and 82KL; Part IVA

42. For a Grower who invests in the Project 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 of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Assessable income from the Project

43. 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

44. Consideration of whether the Lease and the Management fees are deductible under section 8-1 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.

45. A viticulture undertaking involving the growing of grapevines and harvesting of grapes for sale can constitute the carrying on of a business. Where there is such a business, or a future business, the gross sale proceeds from that business will constitute 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 and maintaining of the grapevines, and harvesting of the grapes.

46. 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.

47. Under the Vineyard Lease and the 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 Manager 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 Manager will also arrange for the harvesting of the grapes.

48. The Vineyard Lease and the Management Agreement give Growers an identifiable interest in specific grapevines and Growers have a legal interest in the land by virtue of the lease.

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

50. 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 these indicators. 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.

51. Growers will receive the benefit of professional services through the 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.

52. Growers have a continuing interest in the grapevines from the time they are acquired until the end of the 20 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.

53. 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.

Expenditure of a capital nature

54. 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 fees charged under the Development Agreement, for purchasing and establishing the vines, landcare operations, irrigation, trellising, and mains electricity connection 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.

55. The Manager has identified the relevant expenditures that are of a capital nature in the Development Agreement. Growers entering into the Project incur and pay a separate amount to the Manager for these items, amounting to $13,350. The separate components of this amount are identified at paragraph 20 of this Ruling.

Section 42-15: trellising expenditure

56. Growers accepted into the Project incur expenditure on acquiring and installing trellising, upon which the vines are to be grown, 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.

57. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose 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.

58. 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. Taxation Ruling IT 175 sets out our 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, we accept the lessee is entitled to be recognised as the owner of the fixture for depreciation purposes.

59. 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 Vineyard Lease, the Management Agreement and the Option Agreement, they have a right to remove the trellising at the end of the Project.

60. The Manager will need to advise Growers of the date when the trellising is installed and begins to be used for the purpose of producing assessable income. The cost of $4,000 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 387-55: landcare operations expenditure

61. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on landcare operations on land used to carry on a primary production business. Landcare operations 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 that area. It also includes 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.

62. 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 is not anticipated to be any delay between execution of the relevant documents and commencement of ‘business operations’ on the Grower’s behalf. The work to be done is expressed to come within the meaning of ‘landcare operations’ in

section 387-60. A Grower's primary production business is anticipated to have commenced at the time the expenditure is to be incurred, and the requirements of section 387-55 for a deduction for this expenditure to be allowable will have been satisfied.

Section 387-125: irrigation expenditure

63. 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 are covered by this provision.

64. 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, commencing from the year of income in which the expenditure was incurred. The Manager has identified that the expenditure applicable to the conserving or conveying of water for the Vineyard allotments, amounts to $4,035. For a Grower entering into the Project by 30 June 1999, a deduction of $1,345 will be allowable under section 387-125 for the years ended 30 June 1999 to 30 June 2001 inclusive.

Section 387-165: horticulture expenditure

65. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes, as allowable deductions. 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' encompasses the cultivation of grapevines. For the purpose of section 387-165, 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.

66. 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 Manager will need to advise the Grower of this event, but anticipates that this will be in the income year ended 30 June 2002.

67. Under Subdivision 387-C, of which section 387-165 is a part, 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.

68. 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%, if Growers determine effective life (see subsection 387-175(2) and section 387-185).

Alternative view

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

Section 387-355: electricity connection expenditure

70 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.

71. The deduction is calculated under section 387-355, over a period of 10 years from the year in which 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 the Manager is expressed to satisfy the requirements of section 387-360.

72. 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 Vineyard Lease. The requirements for claiming a deduction under section 387-355 will therefore be satisfied. The Manager anticipates incurring expenditure of $200 in respect of the Electricity

Connection which will result in an allowable deduction of $20 per year for 10 years.

Interest deductibility

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

Section 6-5: assessable income

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

75. 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.

Section 82KZM

76. Section 82KZM operates to spread over more than one income year a deduction for 'advance' expenditure that would otherwise be deductible, in full, under section 8-1, for the year of income in which it was incurred. 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 to be wholly done within 13 months after the day on which the expenditure is incurred.

77. Under the Management Agreement a Management fee of $10,050 per Vineyard Allotment will be incurred upon execution of the Agreement. This fee is charged for providing services to a Grower only for the period of 12 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 able to 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.

78. 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 Fee of $10,050. There is no basis on which to apply section 82KZM to any of the other fees incurred in respect of the Project.

Section 82KL

79. 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'.

80. '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.

81. 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 deductions otherwise allowable under section 8-1.

Part IVA

82. 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).

83. 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.

84. 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.

Detailed contents list

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

Commissioner of Taxation
23 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:
- carrying on a business
- commencement of business
- fee expenses
- horticulture
- interest expenses
- 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 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 318
- ITAA1997 Pt 2-5
- ITAA1997 6-5
- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
- ITAA1997 8-1(1)(b)
- ITAA1997 8-1(2)
- ITAA1997 Div 35
- ITAA1997 35-10
- ITAA1997 35-10(4)
- ITAA1997 35-30
- ITAA1997 35-35
- ITAA1997 35-40
- ITAA1997 35-45
- ITAA1997 35-55
- ITAA1997 35-55(1)
- ITAA1997 35-55(1)(b)

- ITAA1997 42-15
- ITAA1997 42-125
- ITAA1997 387-55
- ITAA1997 387-60
- ITAA1997 387-125
- ITAA1997 Subdiv 387-C
- ITAA1997 387-165
- ITAA1997 387-170(3)
- ITAA1997 387-175(2)
- ITAA1997 387-185
- ITAA1997 387-355
- ITAA1997 Subdiv 387-E
- ITAA1997 387-360
- TAA 1953 Pt IVAAA
- Copyright Act 1968
-

ATO references:
NO 99/4782-5
BO
FOI number: I 1020257
ISSN: 1039-0731
Price: $2.10