



PR 1999/1 - Income tax: Hillston Grove Vineyards Project

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Product Ruling

Income tax: Hillston Grove Vineyards Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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 Hillston Grove Vineyards Project, or just simply as 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are sections 8-1, 42-15, 387-55, 387-125 and 387-165 of the *Income Tax Assessment Act 1997* ('ITAA 1997') and sections 82KL and 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 'Farmers'.

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 39) 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 27 January 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 2001. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Draft Prospectus prepared for Grapes of Australia Management Limited ('GAML' or 'the Manager');
- Project Deed between GAML, Inteq Custodians Limited ('Inteq' or 'the Trustee'), Hillston Grove Vineyards Limited ('HGVL' or 'the Landowner') and Investment Licensing Pty Ltd ('IL') dated 12 May 1998, and Supplemental Deed dated 1 June 1998 containing a Deed of Declaration of Trust;
- Regulation 1 of the Articles of Association for HGVL;
- General Right to Occupy Land Agreement between HGVL and Inteq;
- Draft **Right to Occupy Land Agreement between Inteq and each Farmer**;
- Draft **Management Agreement between GAML and each Farmer**;
- Letters from Mr W Morcom and Pannell Kerr Forster, Brisbane dated between 13 August 1998 and 12 January 1999.

Note: certain information received from Mr W Morcom and Pannell Kerr Forster, Brisbane 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 Farmers enter into. The effect of these agreements is summarised as follows.

14. This arrangement is called the Hillston Grove Vineyards Project. Participants are invited by the Manager to conduct a primary production business of growing grapes as part of the Project, upon certain land under a [crown lease](#) held by HGVL on the property known as 'The Lea South', 25 kilometres west of the town of Hillston in New South Wales. A general right to occupy has been granted by HGVL to Inteq. Inteq, acting on behalf of Farmers, will issue to them a Right to Occupy. Participation in the venture will include:

- A. the Farmer subscribing for 250 'A' class shares in HGVL for a cost of \$1 each, which carry with them a right to occupy/licence for their own vineyard, for 150 vines,
- B. the Farmer entering into a 'Right to Occupy Agreement' with the Trustee in respect of their vineyard in consideration of payments to the Landowner of:
 - 1. a fee of **\$300** per year until year fifteen; and
 - 2. a fee of 7.5% of gross annual farm income from year sixteen;
- C. the Farmer, if he or she chooses the services of GAML, entering into a 'Management Agreement' with GAML for services including the establishment of the vineyard, maintenance, annual harvesting and marketing, under which the Farmer pays GAML:
 - 1. a fee of **\$1,633** comprised of **\$575** for acquisition and installation of trellises, **\$429** for acquisition and installation of above ground drip irrigation, **\$8** for share of cost of roads and mixing pad, **\$283** for share of vermin fence and other land degradation work and **\$338** for pre-planting and planting work;
 - 2. an initial management fee of **\$7,522** for other services to be provided in the first year;
 - 3. a further management fee of **\$1,566** for each of years two and three; and
 - 4. further management fees being the greater of **\$690 or 25%** of the gross sales proceeds from year four.
- D. a Farmer can arrange their own finance to make some or all of the above payments. However, GAML has

made arrangements with a number of lending institutions for the provision of finance to cover the fees payable to the Manager.

15. There are 3,500 ‘farms’ on offer of 150 grape vines per farm at the cost detailed above. The total land area for this stage of the Project is 292 hectares. There is no minimum subscription level. An average of 1,800 vines per hectare will be planted in the 13 months following execution of the Right to Occupy and Management Agreements. Possible projected returns for Farmers are outlined on [page 13](#) of the draft Prospectus. These depend upon a range of assumptions made by GAML. There is no assurance or guarantee whatsoever in respect of the future success of or financial returns associated with the project. Based on the assumptions, the Manager forecasts that a Farmer could expect to achieve an internal rate of return of 12.37% with a cash contribution or 16.21% if funds are borrowed to meet years one to three fees.

Years 1 to 3 hectare rate

16. The fees payable by a participant in the project in the first three years and the equivalent for a one hectare area of land therefore are:

	Year 1 Per 150 vines	Year 1 Hectare rate	Year 2 Hectare rate	Year 3 Hectare rate	Total Y1-3 Hectare rate
Vines	\$338	\$4,056			
Irrigation	\$429	\$5,148			
Trellising	\$575	\$6,900			
Internal roads	\$8	\$96			
Landcare	\$283	\$3,396			
Management fee	Y1 - \$7,522 Y2 - \$1,566 Y3 - \$1,566	\$90,264	\$18,792	\$18,792	
Occupancy fee	\$300/year	\$3,600	\$3,600	\$3,600	
Total	\$13,187	\$113,460	\$22,392	\$22,392	\$158,244

Share ownership and occupancy rights

17. Under the Project a Farmer must subscribe for a minimum of 250 ‘A’ class Ordinary Shares in HGVL, to be paid for on application. Each shareholding entitles the Farmer to a right to occupy one farm containing 150 grape vines for a period of 22 years ceasing on 30 June 2020. After this date shareholders will rank pari passu with holders of other Ordinary Shares. Details regarding the shares and

accompanying special rights are contained in 'Regulation 1 of Articles of Association' for HGVL.

18. GAML have indicated in the draft Prospectus that shareholders could reasonably expect to receive dividend returns on their shareholding, and at the termination of the managed vineyard project would then participate fully in the financial results of HGVL.

Right to Occupy

19. HGVL have entered into a Deed of Trust and a General Right to Occupy agreement with the Trustee, Inteq, who will grant to individual Farmers a Right to Occupy.

20. Farmers entering into a Right to Occupy Agreement will pay occupancy fees to HGVL under clause 1 of this Agreement. Regulation 1 of the Articles of Association for HGVL detail further the rights and obligations in respect of a farm occupancy.

21. Under Regulation 1, with the approval of HGVL's directors, the right to occupy a farm may be leased, assigned, transferred or disposed of or otherwise dealt with, as well as by the transfer of the shares (cl 2). The right to occupy includes the entitlement to use access roads and the agricultural infrastructure on the land (cl 3). Each Farmer will have an exclusive right to occupy a farm, which shall be an identifiable area of land sufficient for a minimum of 150 vines. Each Farmer will be advised of the exact location of their farm (cl 3). On the farm a Farmer may carry on business of grape growing in their own right, may appoint GAML as the Manager, or utilise the services of any competent contractor (cl 4). In consideration for the Right to Occupy an annual occupancy fee is payable to HGVL (cl 9).

Project Deed

22. Participants who choose to utilise the services of, and enter into a Management Agreement with GAML, will be covered by the Project Deed dated 12 May 1998 and the Supplemental Deed dated 1 June 1998 effected between GAML, HGVL, Inteq, and Investment Licensing Pty Ltd (Recital D of the Management Agreement). Participants, by entering into the Management Agreement, agree to the terms of the Project Deed. Inteq will act in a trustee capacity for the participant to review, on a continuing basis, the development and management of the vineyard over the period to 30 June 2020.

Management Agreement

23. Farmers who choose to utilise the services of GAML as the Manager of their farm will enter into a Management Agreement, of

which a summary of the principle provisions of the Agreement appears as Schedule B at pages 34 to 41 of the draft Prospectus.

24. Farmers enter into this Agreement until the year ended **30 June 2020**, or earlier if the Farmer ceases to have a Right to Occupy a farm or termination of the investment deed occurs on an earlier date (cl 3). Upon termination of the Management Agreement an investor has the right to remove the trellising and above ground irrigation lines should they desire to do so (cl 3). This right also appears as clause 11 in the Articles of Association for HGVL.

25. The Manager is to establish the Farmer's vineyard with 150 vines by the end of year one, and identify with appropriate markings the vines in the ownership of each Farmer (cl 4.3).

26. The Farm Management Services to be provided by GAML are detailed at clause 5. These include, amongst other things:

- preplanting and planting services (cl 5.1(a));
- post planting services (cl 5.1(d));
- harvesting the grapes produced and, if the grower elects, making the grapes available to the grower (cl 5.1(f));
- marketing and selling the grape produce (cl 5.1(g)).

27. Farmers have the right to elect to have any grapes harvested from their farm made available to them to sell or deal with as they determine (cl 5.1(f)).

28. GAML is entitled to delegate all or any of the functions to be performed by it pursuant to the Management Agreement, subject to the Landowner's Articles of Association (cl 5.6).

29. GAML will pool for sale all produce of each Farmer's business with that of each other Farmer and will market and sell all such produce. The proceeds of the pooled sales will be paid to the Trustee for crediting to the account of each Farmer on a proportional basis without reference to grape type, quality, volume, prices or any other factor in relation to the Farmer's product or those of any other Farmer (cl 6).

30. Income of the Project is to be held in trust for the Farmers by the Trustee and to be applied in payment of the Farmers' obligations under the Management Agreement. Any net income remaining after the payment of these fees is to be distributed to Farmers within 21 days after the final payment is received for each sale of produce (cl 6.4).

31. The Farmer may terminate the Management Agreement in certain instances, including where the Manager makes default in the performance of its duties (cl 10.2(a)).

32. All costs and expenses incurred by the Manager in carrying out its duties are to be borne by it and the Farmer has no further obligation to make any payment, save those under clauses 9(b) and 9(c) of the Management Agreement (cl 9(d)). However, Farmers will be liable for the payment of any goods and services tax applicable to the supply of the services under this agreement.

33. Pursuant to its right to delegate any functions required of it, GAML have contracted with an external, independent contractor, Lushvale Pty Ltd ('Lushvale'), to undertake the obligations under the Management Agreement to establish the vineyard in year one and undertake all necessary cultural work in both years one and two. A Vineyard Establishment contract exists between GAML and Lushvale detailing those services to be undertaken by Lushvale in both years. A summary of this contract appears as Schedule D at page 42 of the draft Prospectus. Under the contract Lushvale will undertake all preplanting activities, planting of vines, installation of trellising and irrigation, internal roads and firebreaks and carry out the necessary cultural obligations for years one and two.

34. If in any year of the Project the income resulting from the sale of produce is insufficient to meet the annual management and occupancy fees of that year, participants are still liable to pay the shortfall and any shortfall may be deducted from future years' income under clause 26.3(iii) of the Project Deed.

35. There are no sale agreements in place for the grapes that will be produced and harvested under the Project. Farmers are paying, as part of the management fees in years one to three, an amount to GAML for it to market and sell the grapes (cl 5.1(g)).

Other fees payable by an investor

36. A participant who enters into the Hillston Project and chooses to utilise the services of GAML will be bound by the Management Agreement and Project Deed. These documents detail, amongst other things, the fees and charges for which an investor is liable. In addition to the fees that have been detailed above, an investor may be liable, in certain circumstances, for a number of other fees and charges, which are not able to be currently quantified. These include the possibility, should the need arise, of:

- the Manager retaining and applying income of the Project in meeting outgoings of a capital nature (cl 29.3, Project Deed);
- the Manager creating from time to time provisions for future expenditure or liabilities of a Farmer's interest (cl 29.4, Project Deed);

- the Manager charging for any taxes and duties required to be paid by the Project (cl 29.5, Project Deed); and
- the Manager passing on any goods and services tax that might become applicable to either the supply of the services under the Management Agreement (cl 9(d)), or occupancy fees under the Right to Occupy Agreement (cl 3).

Vineyard establishment

37. Under the Management Agreement, once a Farmer has subscribed for shares in HGVL, and elected to use the services of GAML, GAML will be responsible for planting 150 vines on each farm no later than the following 30 June (cl 4.3). For persons who are accepted as Farmers on or before 30 June 1999, it is proposed that certain preplanting work will have been carried out for them before this time. For example, for the purposes of advising Farmers about their taxation claims, specifically when certain ‘business operations’ have been commenced on their behalf, the Manager will advise them of when their trellising and irrigation items are installed, and when their vines have been planted.

Finance

38. Farmers can fund their investment in the Project themselves, borrow from an independent lender, or borrow through finance arrangements organised by GAML. Finance arrangements organised directly by a Farmer with independent lenders are outside the arrangement to which this Ruling applies. GAML has engaged the services of Laton Securities Pty. Ltd. (‘Laton’), a company not associated with GAML or any associates of GAML, to arrange loans from a number of independent financiers, to cover the fees payable to GAML.

39. The ‘Laton’ loans will be on normal commercial terms; they will be both in form and substance, full recourse, and borrowers will be obliged to make the regular repayments regardless of any income being derived from the Project. GAML will be put in funds directly as a result of these loans, on the Farmer being accepted as a borrower. GAML will not be putting any of these funds on deposit with Laton, or any of the financiers in question, or any associated persons, but will substantially use these funds, subject to the Trustee’s approval, in carrying out its obligations under the Management Agreement.

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Ruling

40. For a Farmer who invests in the Project by 30 June 1999, who utilises the services of GAML and does not elect to have the grapes produced made available to themselves, the following deductions will be available for the years ended 30 June 1999 to 30 June 2001:

		Deductions available each year		
		Year 1	Year 2	Year 3
Year ended		30/6/1999	30/6/2000	30/6/2001
Fee type	ITAA 1997 section			
Management fee	8-1	\$7,522	\$1,566	\$1,566
Occupancy fee	8-1	\$300	\$300	\$300
Landcare	387-55	\$283 (see Note 1 below)		
Irrigation	387-125	\$143 (see Note 2 below)	\$143	\$143
Preplanting and planting	387-165			\$44 (see Note 3 below)
Trellising	42-15	(see Note 4 below)	\$75	\$75
Interest on loan	8-1	as incurred	as incurred	as incurred

Notes:

1. Deductibility under section 387-55 is dependent on the Farmer carrying on a 'primary production business' at the time the expenditure in question is incurred. A Farmer who applies and is accepted into the project on, say, the 30 June 1999, but for whom no services are provided in that year of income, will not be considered to be carrying on such a business.
2. Deductibility under section 387-125 is calculated on the basis of one-third of the capital expenditure in the year in which the expenditure is incurred, and for each of the next 2 years of income.
3. Deductibility under section 387-165 is calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in July 2001, and a Farmer determining under section 387-175 that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years, resulting in a write-off rate of 13%.
4. Deductibility under section 42-15 for depreciation, for the year ended 30 June 1999, will depend, for the purposes of either section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method',

on the number of 'days owned', being the number of days in the income year in which the farmer owned an interest in the trellising. GAML is to advise farmers of this for the year ended 30 June 1999. Deductions for the two succeeding years have been calculated, for illustrative purposes, on the basis of using the prime cost method at a rate of 13%, assuming that is the method that the Farmer has chosen under section 42-25.

41. For a Farmer who invests in the Project between 1 July 1999 and 30 June 2000, the deductions available to them for the year ended 30 June 2000 will be as detailed above for year one, and for the year ended 30 June 2001 will be as detailed above for year 2.

42. For a Farmer who invests in the Project any income received by them from the sale of grapes from their 'farm' will be assessable income to them under section 6-1 of the ITAA 1997.

Sections 82KZM and 82KL; Part IVA

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

- i. the expenditure by farmers does not fall within the scope of section 82KZM;
- ii. section 82KL does not apply to deny the deductions otherwise allowable; and
- iii. Part IVA does not apply to deny deductions for the expenditure by growers or interest on any loans taken out to fund payment of their expenditure.

Explanations

Section 8-1

44. Consideration of whether the occupancy and management 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 a 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 all that happens in a year of income is that 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 the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

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

46. Under the Management Agreement a Farmer can elect to either farm their vineyard area themselves, engage a manager other than GAML or utilise the services of GAML. They also have the right to have the harvested grapes made available to themselves to sell or utilise how they wish. The purpose for which the participant utilises the grapes will then be a determining factor as to whether the amounts incurred on any occupancy or management fee will be an allowable deduction. This Ruling applies to those parties utilising the services of GAML.

Is the Farmer in business?

47. Generally, a Farmer will be carrying on a business of viticulture where:

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

48. By weighing up all of the attributes of the Project it is accepted that Farmers 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 co-ordinated and concerted plan to grow and harvest grapes for sale at a profit.

49. For this Project investors have, under the Right to Occupy and Management Agreements, rights in the form of an occupancy right over an identifiable area of land growing 150 vines, consistent with the intention to carry on a business of growing grape vines. They also have a beneficial interest in the general right to occupy the land as held by the Trustee and the improvements to the land for the duration of the venture. At the termination of the Management and Right to Occupy Agreements, Farmers also have the right to remove the trellising and above ground irrigation lines, should they desire.

50. Under the Right to Occupy and the Management Agreements, Farmers appoint GAML, as Manager, to provide services such as preplanting and planting of grape vines, the installation of trellising and irrigation, and all cultural operations necessary to develop a mature fruit bearing vine.

51. Farmers have the right to use the land in question for viticulture purposes and to have GAML come onto the land to carry out its obligations under the Management Agreement. The Farmers' degree of control over GAML, as evidenced by the Agreements, and supplemented by the Corporations Law, is sufficient. Under the general terms of the project, Farmers are entitled to receive regular progress reports on GAML's activities. Farmers are able to terminate arrangements with GAML in certain instances, such as cases of default. The viticulture activities described in the Right to Occupy and Management Agreements are carried out on the Farmers' behalf. Farmers control their investment.

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

53. Farmers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify which vines Farmers have an interest in. 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.

54. Farmers have a continuing interest in the vines from the time they are acquired until the termination of the Project. 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 Farmers' viticulture activities will constitute the carrying on of a business.

Deductibility of expenses

55. The occupancy and management fees payable in years one, two and three, 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 is to be gained. They will thus be deductible under the first limb of section 8-1, to the extent that they are not capital or of a capital nature (see further below). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. **The fees, on the basis of the information provided, cannot be said to be grossly excessive.** The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply, except as set out below.

Expenditure of a capital nature

56. Any part of the expenditure of a Farmer entering into the viticulture 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 of the ITAA 1997. It is apparent from the Project's Agreements that certain payments made are attributable to the acquisition of capital assets. This includes preplanting costs, the cost of establishing the vines, and the erection and establishment of such items as trellising and irrigation to support and water the vines. However, expenditures of this nature can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production, and under the general depreciation provisions of the ITAA 1997.

57. The Manager, GAML, has identified the relevant expenditures which are of a capital nature. A Farmer entering into the Project incurs and pays a separate amount to GAML for these capital items amounting to \$1,633 (refer clause 9(b) of the Management Agreement). These amounts are detailed at paragraph 14 of this Ruling.

Landcare provisions – Subdivision 387-A, ITAA 1997

58. 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 of the ITAA 1997. The expenditure that qualifies includes, amongst other things, the eradication of animal and vegetable pests and other measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (see section 387-60).

59. 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 that 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 Farmer's business of primary production will generally have commenced at the time that the expenditure was incurred. The necessary requirements under Subdivision 387-A will thus have been met in this respect.

60. However, where all that occurs in an income year, is that a person has been accepted into the project as a Farmer, but no business operations have been commenced on their behalf, they will not be accepted as having commenced a primary production business, and no deduction under Subdivision 387-A will be allowable for that, or any other, year of income.

61. The Manager, GAML, has identified that the relevant expenditure attributable to eligible Landcare measures for the purposes of sections 387-55 and 387-60, is **\$283**. A deduction for this amount will be allowed in the year in which a participant enters into contractual arrangements with GAML and commences to carry on a primary production business.

Expenditure on conserving or conveying water – Subdivision 387-B, ITAA 1997

62. Capital expenditure incurred by a person carrying on a primary production business, on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in such a business, qualifies for a write off over a three year period (i.e., $33\frac{1}{3}\%$ with no pro rating required), under Subdivision 387-B of the ITAA 1997, specifically section 387-125. A taxpayer incurring this expenditure need not be the owner of the land to claim the deduction, so long as they are in a business of primary production. In this case there will generally be no delay between the signing of the

Agreements and the commencement of 'business operations'. Accordingly, a Farmer's business of primary production will generally have commenced at the time the expenditure was incurred. The requirements of Subdivision 387-B have thus been met in this respect.

63. The Manager, GAML has identified that the expenditure applicable to the conserving or conveying of water for the vineyards, **that meets the requirements of section 387-130**, amounts to **\$429**. For a Farmer 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 **\$143** per year.

Horticultural provisions – Subdivision 387-C, ITAA 1997

64. The capital costs relating to establishing the vines are not able to be written off under Subdivision 387-D of the ITAA 1997, as the licensee Farmer will not be the 'owner' of the vines for the purposes of these 'write off' provisions. However, these capital costs are deductible as a 'write off', over time, under Subdivision 387-C of the ITAA 1997. This Subdivision allows capital expenditure incurred in establishing horticultural plants to be written off where the plants are used in a business of 'horticulture'. Under subsection 387-170(3), the definition of 'horticulture' covers the cultivation of grapevines.

65. The write off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in a horticultural business (see sections 387-165 and 387-170). The write off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). The write off deductions will, for a Farmer who has been accepted into the project by 30 June 1999, and whose primary production business has commenced, start in the third year of the project, on the basis it is then the grapevines enter their first commercial season, and hence begin to be used for the purpose of producing assessable income in a horticultural business.

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

67. The Manager, GAML, has identified that the relevant expenditure attributable to the establishment of the vines is **\$338**. This amount will be subject to the horticultural provisions, and allowable as a deduction under Subdivision 387-C.

68. For a Farmer entering into the project by 30 June 1999 no deduction will be allowable for the years ended 30 June 1999 or 30

June 2000. A deduction will be available for the year ended 30 June 2001. This will be for the amount of \$44.

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 inclusion of propagation and cultivation within the meaning of 'horticulture' under the relevant provisions, the timing aspects of other distinctions drawn between capital and revenue costs and the acceptance of the use of the trellises for income producing purposes from the earlier time.

Trellising – section 42-15, ITAA 1997

70. Farmers accepted into the project incur a number of expenses under the Management Agreement for items of plant, which are to be used on their behalf in the operation of the vineyard business. Such expenditure includes that on Trellising upon which the vines are attached. This is attached to the land as a fixture. This expenditure is also of a capital nature.

71. Generally speaking, if a taxpayer incurs expenditure of a capital nature on plant or equipment, used during the year of income for the purposes of producing assessable income, and it is expenditure to which Section 42-15 of the ITAA 1997 applies, a deduction will be allowed for depreciation on the item under that section. 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.

72. However, we accept in certain circumstances a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. In Taxation Ruling IT 175 we set 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 claim depreciation for the fixture.

73. A Farmer accepted into the Project enters into an Agreement for a right to occupy certain land upon which they are entitled to grow vines to conduct a business of viticulture. Under the Management Agreement, and as acknowledged in the Articles of Association of

GAML and HGVL, they have a right to remove the trellising at the end of the Project.

74. A deduction for depreciation is allowable on plant from the date it is installed and ready for use. The Manager, GAML, will advise Farmers when the trellising is installed and begun to be used for the purpose of producing assessable income.

75. As such, the cost of \$575, that relates to the acquisition and installation of trellises on the land, will be eligible for depreciation deduction by the farmers under section 42-125, at a rate of 13% prime cost or 20% diminishing value. Using the prime cost method this equates to a deduction of \$75 for the years ended 30 June 2000 to 30 June 2001.

Section 82KZM

76. Under the Right to Occupy Agreement the fee of **\$300 per farm** area of 150 vines will be incurred on execution of that Agreement. Under the Management Agreement a fee of **\$9,155** will be incurred on execution of that Agreement to undertake preplanting, planting and post planting services for the first year. In addition, management fees of **\$1,566** are payable in each of years two and three. In each instance the fees are charged for providing services to a Farmer 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 respect of clauses 5.1(d) to (j), in the first year of the project, compared to years two and three.

77. No explicit conclusion can be drawn from the arrangement's description, 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 fee could not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, no part of the first year fee of **\$9,155** or for the fees incurred in years two and three is for GAML doing 'things' that are not to be wholly done within 13 months of each fee being incurred. On this basis the basic precondition for the operation of section 82KZM is not satisfied, and it will not apply to the expenditures identified above in each of the financial years ended 30 June 1999 to 30 June 2001.

Section 82KL

78. The operation of section 82KL depends, amongst other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided to the Farmer. The loan will be

provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this loan, to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

79. 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 Hillston Grove Vineyard Project** will be a 'scheme'. It will commence generally on the date the Prospectus is issued. The Farmers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the occupancy fees and management fees allowable under section 8-1, and deductions allowable under Subdivisions 387-A, 387-B and 387-C, and section 42-15, 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.

80. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the yearly sale of grapes or grape juice. Further, there are no features of the Project, for example, such as the occupancy and management fees of **\$9,455** being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, 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.

Assessable income

81. Gross sale proceeds derived from the sale of grapes harvested from the project will be assessable income of the Farmers, under section 6-1, in the year in which a recoverable debt accrues to them. This will depend on the terms of the specific sale contracts entered into.

Interest deductibility

82. Some Farmers intend to finance the investment through a loan facility. Whether the resulting interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the occupancy and management fees are deductible. The interest fees incurred will be in respect of a loan to finance the establishment of the vineyard, and its development in the first years - which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, thus, also have a sufficient connection

with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Detailed contents list

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Commissioner of Taxation

27 January 1999

Previous draft:

No Draft issued

Related Rulings/Determinations:

PR 98/1; TR 92/1; 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:

- ITAA36 82KL
- ITAA36 82KZM
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 8-1

Case references:

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