



PR 1999/62 - Income tax: Yelloch Creek Estate Vineyard Project

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Product Ruling

Income tax: Yelloch Creek Estate Vineyard Project

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Preamble

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Yelloch Creek Estate 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 100-55 of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- section 387-165 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 388-55 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM of the ITAA 1936;

- 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.

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 identified in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 11 to 52) 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 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. The capitalisation of a term indicates that the term is defined in the relevant document or agreement. This description incorporates the following documents:

- Application for Product Ruling dated 22 February 1999;
- The Management Agreement supplied with the Application and the subsequently amended Management Agreement supplied on 12 May 1999, between Yelloch Creek Estate Ltd ('the Manager') and the Grower;

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- The Head Lease supplied with the Application and the subsequently amended Head Lease supplied on 12 May 1999, between Ronlae Vineyard Pty Ltd ('the Lessor') and Yelloch Creek Estate Limited ('the Lessee');
- The Vineyard Lease supplied with the Application, between Yelloch Creek Estate Limited ('the Lessor') and the Grower ('the Lessee');
- The Option Agreement supplied with the Application, between Ronlae Vineyard Pty Ltd ('the Land Owner') and the Grower;
- The Constitution for the Yelloch Creek Estate Vineyard Project supplied with the Application, between Yelloch Creek Estate Limited ('the Responsible Entity') and the Growers;
- The Compliance Plan for the Yelloch Creek Estate Vineyard Project supplied on 13 April 1999 and the subsequently amended Compliance Plan supplied on 12 May 1999;
- The Development Plan (which forms part of the Management Agreement as Annexure 'E'), supplied on 13 April 1999;
- The Management Plan (which forms part of the Management Agreement as Annexure 'F'), supplied on 13 April 1999;
- The Fruit Purchase and Sale Agreement supplied on 13 April 1999, between BRL Hardy and Yelloch Creek Estate Limited (as Grower);
- Copy of initial draft Prospectus received 14 April 1999, a second draft Prospectus supplied on 12 May 1999 and the final Prospectus supplied on 20 May 1999;
- Copy of the (unsettled) Contract of Sale between Ronlae Vineyard Pty Ltd ('the Purchaser') and Heather Bourne and Jeanette Rodda ('the Vendors'), supplied on 22 April 1999;
- copy of tax opinion by Mr John De Wijn QC;
- additional correspondence received from PriceWaterhouseCoopers dated 13, 16, and 22 April 1999 and 12 and 20 May 1999; and
- correspondence from PriceWaterhouseCoopers to the nominated lender supplied on 16 April 1999.

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

13. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate within the meaning of section 318 of the ITAA 1936, will be a party to, except for the provision of finance to which paragraphs 51 and 52 apply.

14. All Australian Securities and Investment Commission requirements are, or will be, complied with for the term of the Agreements.

15. The effect of these agreements relating to the Project is summarised as follows.

16. This arrangement is called the 'Yelloch Creek Estate Vineyard Project' and has been registered as a managed investment scheme under the Corporations Law. Growers entering into the Project must make the following payments for each 1 acre portion of the Vineyard Allotment:

- \$20,862 by 30 June 1999 comprised of \$1,624 for the purchase and installation of trellising; \$1,924 for the purchase and installation of irrigation infrastructure; \$1,158 for the purchase and planting of rootlings; \$70 for other capital costs; a Management Fee of \$15,830 for Vineyard Services to be provided in the Financial Year ended 30 June 2000; and \$256 for Rent for the Financial Year ended 30 June 2000;
- a Management Fee of \$5,926 by 30 June 2000 for Vineyard Services to be provided in the Financial Year ended 30 June 2001 plus an amount for Rent calculated as the amount payable for the previous Financial Year, Indexed;
- a Management Fee of \$2,850 by 30 June 2001 for Vineyard Services to be provided in the Financial Year ended 30 June 2002 plus an amount for Rent calculated as the amount payable for the previous Financial Year, Indexed; and
- thereafter, a Management Fee determined in accordance with Annexure 'B' of the Management Agreement plus an amount for Rent calculated as the amount payable for the previous Financial Year, Indexed.

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Years 1 to 3 per hectare rate

17. The fees payable by a participant in the Project in the first three years expressed as the equivalent for a one hectare area of land, assuming Rent is indexed at 2.5%, are:

	Year 1 Hectare rate	Year 2 Hectare rate	Year 3 Hectare rate
Management fee	\$39,575	\$14,815	\$7,125
Rent	\$640	\$658	\$672
Irrigation	\$4,810	Nil	Nil
Purchase and planting of rootlings	\$2,895	Nil	Nil
Trellising	\$4,060	Nil	Nil
Other capital costs	\$175		
Total	\$52,155	\$15,473	\$7,797

The total years 1 to 3 cost to the Grower is \$75,425 per hectare.

Overview

18. In general terms, the Project involves Yelloch Creek Estate Ltd ('YCEL') entering into a Lease with Ronlae Vineyard Pty Ltd ('Ronlae') for the lease of the Vineyard Land. The Vineyard Land comprises a 200 acre property in the vicinity of Naracoorte, South Australia of which 185 acres are stated to be suitable for growing vines.

19. Growers taking part in the Project will appoint YCEL as their attorney to enter into the following agreements on their behalf:

- a Management Agreement under which Growers appoint YCEL as Manager of their Vineyard;
- a Vineyard Lease under which YCEL subleases to Growers one or more Vineyard Allotments; and
- an Option Agreement under which Ronlae grants an option for Growers to sell the Grower's Improvements to it at or around the termination of the Vineyard Lease.

20. There are 185 Vineyard Allotments on offer of 1 acre (0.4 ha) each and Growers must subscribe for a minimum of one Vineyard Allotment. The minimum number of subscriptions is 95 Vineyard Allotments and if this is not achieved by 30 June 1999, all Growers' contributions will be refunded. Generally, the Term of Vineyard Leases will be until 30 June 2014.

21. The projected returns for Growers are outlined on pages 17 to 19 of the Prospectus. Those projections show that over the life of the Project, for a Vineyard Allotment financed by the nominated lender, projected income will exceed projected tax deductions by \$30,018, projected tax payments exceed projected tax deductions by \$14,559, pre-tax cashflows are positive to the extent of \$30,019, and after-tax cashflows are positive to the extent of \$15,458. Growers are forewarned in the Prospectus that neither YCEL, Ronlae, nor their advisors, experts or Directors guarantees the success of the Vineyard, the repayment of capital or any particular rate of return for participation in the Project. The projected returns depend of a range of assumptions.

Head Lease

22. Ronlae has entered into an agreement to lease the Vineyard Land to YCEL for the Term of the Project (cl 2.1). YCEL can only use the land for the purpose of the Project (cl 5) and it undertakes to use Best Viticultural Practice in its Development of the Vineyard Allotments (cl 6).

23. Ronlae acknowledges that all plant, equipment and other property (cl 7.1) and Vines and vine rootlings (cl 7.2) installed on the Vineyard Land by YCEL, on behalf of the Growers, will be owned by the Growers. Growers will have the right to harvest and take as their own, all Grapes during the Term (cl 7.3).

Vineyard Lease

24. Under the Vineyard Lease, YCEL subleases to the Grower an area of the Vineyard Land called the Vineyard Allotment, as well as, in common with other Growers, the Common Area, for the Term of the Project (cl 2.1). The Grower is required to pay the Rent to YCEL annually in advance on or before the 30 June preceding the commencement of each Financial Year (cl 3).

25. The Grower is only able to use the Vineyard Allotment for the purposes of the Project. (cl 6.1). YCEL will have no right, title, interest or claim in the Grower's Improvements (cl 8.1). Grower's Improvements are defined to include posts, trellises, vines, vine rootlings, grapes and irrigation equipment. Apart from the Grape Sale Agreement, the Grower will have the right to harvest and take as its own any Grapes during the period (cl 8.2). Dealings, including assignment, in respect of the Vineyard Allotment and Common Area, can only be effected in accordance with the Constitution (cl 12).

26. Clause 13 provides for the circumstances by which YCEL can terminate the Vineyard Lease. Under clause 13.1(a) this may happen

if the Rent or any other amount payable is not made within one month of receiving a notice to pay the relevant amount. Under clause 13.1(b) this may happen if the Grower is in default of its obligations under the Lease and fails to remedy that default after being given written notice to do so.

Management Agreement

27. The Grower engages YCEL as an independent contractor to carry out the **Development Services** in consideration of the **Subscription Fees** and the **Vineyard Services** in consideration of the **Management Fee** (cl 4.1). The Manager has commenced or must commence to carry out the Development Services and the Vineyard Services on or before the Commencement Date (cls 4.3 and 4.4). The Commencement Date is defined in each agreement to be the date of that agreement. The Grower authorises the Manager to enter into Grape Sale Agreements and ratifies any such Agreements entered into prior to the Commencement Date (cl 4.6).

28. The Development Services are set out in Annexure 'D' of the Management Agreement and are described as preliminary works, choosing grape varieties, acquisition and planting of grapevines, and purchase and installation of irrigation and trellising.

29. The Vineyard Services must be provided in accordance with Annexure 'C', the Development Plan and the Management Plan (cl 5.1). Annexure 'C' details the Vineyard Services and the Development Plan and the Management Plan (Annexures 'E' and 'F') provide a timetable for the provision of those Services. The Vineyard Services include pruning, irrigation and fertilisation, soil management, control of vermin, insects and disease, spraying, culling of vines and grapes, nursery work, harvesting, transporting and selling the grapes, and other things related to the ongoing management of the Vineyard Allotment.

30. YCEL gives no warranty as to the yields and as to the quality and quantity of the Grapes from the Vineyard Allotment or the Vineyard (cl 5.2). Each Grower's Grapes will be pooled and the proceeds of sale will be shared amongst the Growers in accordance with the Constitution (cl 5.6). The Grower may make recommendations in respect of the performance of the Vineyard Services and YCEL must consider, but is not obliged to act, on the recommendations (cl 5.7).

31. The Grower will at all times during the Term, own all plant, equipment and other property installed on the Vineyard Allotment, including but not limited to, posts, trellises, rootlings and Vines, and the Grapes (cl 6.1).

32. The Grower must pay the Management Fee to YCEL annually in advance on or before the 30 June in the preceding Financial Year (cl 10.1) and the Subscription Fee on or before the 30 June 1999 (cl 10.2). The Grower also authorises YCEL to deduct the Harvest Fee from the Proceeds Fund (cl 10.4). The Harvest Fee is described in Item 6 of the Schedule as being 2% of the gross proceeds of the sale of the Grapes whether sold under the Grape Sale Agreements or otherwise. YCEL is also entitled to deduct any other amounts outstanding from moneys due to the Grower under the Grape Sale Agreements (cl 10.5).

33. YCEL is required to prepare and provide the Grower with a proper Management Plan for the whole of the following Financial Year (cl 11.1). YCEL must also provide Growers with quarterly reports for the first four Financial Years in respect of the Vineyard Services provided, the progress and condition of the Vineyard and any other matters which are considered material (cl 13.1). A yearly report in respect of similar issues must also be prepared and forwarded by the YCEL to the Growers (cl 13.2). The Grower is also able to request written information on other matters relating to the Project provided such requests are reasonable (cl 13.3).

34. The Grower may at any time terminate the Management Agreement if the Manager defaults in its performance, the Lease is terminated or the Manager retires or is removed as Responsible Entity (cl 15.1). The Manager may terminate the Management Agreement where the Grower fails to pay fees after being served with a notice to pay, the Grower defaults under the Agreement, the Lease is terminated or the Vineyard Project is terminated in accordance with the Constitution (cl 15.2).

Option Agreement

35. Under the Option Agreement the Land Owner grants an option to the Grower to sell the Grower's Improvements to Ronlae for the Improvements Fee (cl 2.1) of \$10,000.

36. This option can only be exercised during the period of 30 days prior to and 30 days after the termination of the Vineyard Lease (cl 3.1).

37. Where the Grower elects to exercise the Improvements Option, a notice in writing must be served on Ronlae that the option will be exercised (cl 4). Ronlae must pay the Improvements Fee within 90 days of receiving a valid Improvements Option Notice (cl 5.1).

38. Where a Grower does not validly exercise the Improvements Option, the Grower must remove the Grower's Improvements from the Vineyard Allotment within 30 days. If the Grower's Improvements are not removed the Grower's Improvements are

deemed to be worthless and Ronlae is entitled to keep them and is not required to pay the Grower any compensation (cl 9.1).

The Compliance Plan

39. The purpose of the Compliance Plan is the protection of the Growers' interests. Among other things, Part 2 provides that YCEL will act in the interests of Growers in preference to its own, ensure that the Constitution and the Compliance Plan meet the relevant requirements of the Corporations Law, ensure that all property of the Project is clearly identified and held separately from any other property of YCEL or other managed investment schemes and ensure that the assets of the Project are regularly and appropriately valued. To address the risks to the Growers:

- all Project property will be held by the Custodian, Sandhurst Trustees;
- Bruce Morrison, a director, has been appointed as Compliance Officer; and
- a Compliance Committee comprising a majority of external members has been appointed.

The Constitution

40. The parties to the Constitution are stated to be YCEL (the Responsible Entity) and the Growers. Under clause 3, an Applicant acquires an Interest by paying YCEL the amount specified in the Prospectus.

41. Growers do not have the right to withdraw from the Project or require YCEL to purchase their Interests (cl 9). 'Interest' is defined to mean the Grower's interest in the Project including the interest in the Vineyard Lease, the Management Agreement and the Grape Sale Agreement.

42. Clause 18 provides that a Grower may sell or assign an Interest subject to the terms and conditions of the Project Agreements. Clause 18.2 provides for the form an assignment must take and clause 18.3 provides for the circumstances under which such assignment can be refused by YCEL.

43. Growers may remove YCEL as Responsible Entity by an extraordinary resolution passed at a meeting of Growers, provided that the Growers resolve to appoint a Company to act as new Responsible Entity of the Project (cl 31.2).

Grape Sale Agreement

44. YCEL have entered into an agreement with BRL Hardy for the sale of grapes grown on 40 hectares of the Vineyard over a 10-year period commencing on 30 June 1999 (cl 1). This period may be extended by 3 years (cl 3) and the maximum cropping level is 12.5 tonnes per hectare. Clause 4 provides for the identification of the specific 40 hectares to which the agreement applies and clause 5 indicates that the plantings on the identified area will consist of 8ha each of two varieties of Cabernet Sauvignon, two of Shiraz, and one of Merlot.

Financing

45. The applicant has stated in correspondence that neither YCEL nor Ronlae, nor any entity related to, or associated with either will offer finance to Applicants to enable participation in the Project. However, discussions have taken place with an Australian bank for it to consider applications from Applicants for finance during the first three years of the Project. Such applications will be on a case-by-case basis and will be on the normal terms and conditions of the bank. The lender will have full recourse to the Grower and, as security, each Grower may be required to provide a personal guarantee. Applicants are informed in the Prospectus that applications for finance are subject to approval and will not be binding on either party.

46. This Ruling only applies to loan agreements that exhibit the following features:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and lenders will take 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, agreements to reduce the borrower's liability; and
- repayments of principal and payments of interest will not be linked to derivation of income from the Project, and will be made regularly over the period of the loan in accordance with the terms and conditions applying to the loan.

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Ruling

47. For a Grower who invests in the Project by 30 June 1999 and who incurs the fees set out in paragraph 16, and who utilises the services of the Responsible Entity, the following deductions will be available for each 1 acre allotment for the years ended 30 June 1999 to 30 June 2001:

Fee type	ITAA 1997 section	Deductions available each year		
		Year 1	Year 2	Year 3
		30/6/1999	30/6/2000	30/6/2001
Management fee	8-1	\$15,830	\$5,926	\$2,850
Rent	8-1	\$256	see Note (i) below	see Note (i) below
Irrigation	387-125	\$642 see Note (ii) below	\$641	\$641
Purchase and planting of Vines	387-165	see Note (iii) below		
Trellising	42-15	see Note (iv) below	see Note (iv) below	see Note (iv) below
Interest on loan	8-1	as incurred	as incurred	as incurred

Notes:

- (i) The deduction for Rent in Years 2 and 3 will depend on the CPI index for the previous Financial Year.
- (ii) 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.
- (iii) A deduction under section 387-165 for expenditure on acquiring and planting the vines is calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in the year ended 30 June 2002 and a Grower 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%.
- (iv) 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 Grower owned an interest in the trellising. YCEL is to advise Growers of this for the year ended 30 June 2000. Deductions for the two succeeding years will depend on whether the Diminishing Value Method or Prime Cost Method is used.

Assessable income

48. For a Grower who invests in the Project, gross income received by them from the sale of grapes from their Vineyard Allotment will be assessable income under section 6-5 in the year in which a recoverable debt accrues to them.

Part 3-1: capital gains and losses

49. A change of ownership of the Grower's Improvements at the end of the Term, either by the exercise of the Improvements Option or by a Grower failing to, or choosing not to exercise the Improvements Option, may give rise to either a capital gain or a capital loss. Growers must include any net capital gain of an income year in their assessable income for that year, under section 100-55.

Sections 82KZM and 82KL; Part IVA

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

- 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.

Explanations**Section 8-1**

51. Consideration of whether the management fees 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 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 outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

52. 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, section 8-1, provided it is not a loss of capital or expenditure 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 assessable income under section 6-5.

53. 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 grapevines and the harvesting of the grapes.

54. Under the Management Agreement a Grower engages YCEL to grow, harvest and sell grapes from the Grower's Vineyard Allotment.

55. This Ruling applies only to those parties engaging YCEL to provide management services, including the harvesting of the grapes and the selling of the grapes, according to the terms of the Grape Sale Agreement or any similar commercial agreement for the sale of grapes.

Is the Grower in business?

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

- they have an identifiable interest in 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, points to them carrying on such a business.

57. The Management Agreement gives Growers full ownership of the grapes at all times during the Term. The Project documentation contemplates Growers will have an ongoing interest in the growing vines - the vines are the Growers' property and Growers have a legal interest in the land, being the Lease itself, consistent with the intention to carry on a business of growing grapes. At the termination of the Management Agreement, Growers also have the obligation to remove the vines, trellising and irrigation system on their Vineyard Allotment, unless the Improvements Option is exercised, under which Ronlae acquires the Grower's Improvements. Where a Grower fails to exercise the Improvements Option and also fails to fulfil the obligation to remove the Grower's Improvements, the Grower forfeits the improvements without right of compensation.

58. Growers have the right to use the land in question for grape-growing purposes and to have YCEL come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over YCEL, as evidenced by the Project Agreements and supplemented by the Corporations Law, is consistent with ordinary business practices. Growers are able to terminate arrangements with YCEL where certain conditions are not met.

59. Services provided by YCEL under the Management Agreement are of the type ordinarily found in grape-growing ventures.

60. 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. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections 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.

61. Given the nature of the Project, it is accepted that Growers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf.

62. The grape-growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities. The Grower's grape-growing activities will constitute the carrying on of a business when the Grower has entered into the Management Agreement and the Manager has commenced providing services.

63. The rent and management fees associated with the grape-growing 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 derived.

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64. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions in section 8-1(2) do not apply, except as set out below.

65. Rent and management fees are pre-paid. Taxation Ruling TR 94/25 states that the facts in *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* (1993) 176 CLR 640; 93 ATC 4214; (1993) 25 ATR 95 were fundamentally different from those of a pre-payment and that the decision did not affect the deductibility of pre-paid expenses. The rent and management fees will be incurred in the year of payment.

Expenditure of a capital nature

66. Any part of the expenditure of a Grower entering into a primary production 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. It is evident from the Project documentation that separate amounts are payable by Growers to cover the capital costs of carrying on their business as follows:

- purchase and installation of irrigation infrastructure;
- purchase and planting of vines;
- purchase and installation of trellising; and
- other capital costs.

67. 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.

Subdivision 387-B: expenditure on conserving or conveying water

68. 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, specifically, section 387-125. It is not necessary for a taxpayer incurring this expenditure to be the owner of the underlying land to claim the deduction, so long as they are in a business of primary production on the land. YCEL will commence to carry on the primary production business on behalf of a Grower upon execution of the Management Agreement. Accordingly, a Grower's business of primary production will commence at the time the expenditure is

incurred. The requirements of Subdivision 387-B have, thus, been met in this respect.

69. YCEL has identified that the expenditure applicable to the conserving or conveying of water for the Vineyard Allotments, that meets the requirements of section 387-130, amounts to \$1,924. For a Grower entering into the Project by 30 June 1999 and commencing to carry on a primary production business by that date, a deduction will be allowable under section 387-125 for the years ended 30 June 1999 to 30 June 2001 inclusive, of \$642 in year one and \$641 in the following two years.

70. However, a deduction under section 387-165 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and elects to do so.

Subdivision 387-C: vines and horticultural provisions

71. The capital costs relating to establishing the vines are not able to be written off under Subdivision 387-D, as the Grower will not be the 'owner' of the vines for the purposes of these 'write-off' provisions. However, capital expenditure incurred in establishing horticultural plants can be written off where the plants are used in a business of 'horticulture' under Subdivision 387-C.

72. 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.

73. By operation of section 387-165, a taxpayer is entitled to a deduction in respect of capital expenditure incurred on establishing a horticultural plant in an income year where the taxpayer:

- is the first to use the horticultural plant (or hold it ready for use) for commercial horticulture; and
- owns the plants when it is first used (or held ready for use) for commercial horticulture.

74. Under subsection 387-170(3), the definition of 'horticulture' covers the cultivation of grapevines. The vines are first used for commercial horticulture upon commencement of commercial production of fruit. Section 387-210 deems the rootstock to be owned by the Grower as lessee of the land. Therefore, the requirements for deductibility under section 387-165 are first satisfied when the grape vines enter their first commercial season. The write-off commences at that time (see sections 387-165 and 387-170).

75. 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 Grower who has entered into the Project and whose primary production business has commenced by 30 June 1999, start in the year ended 30 June 2002, on the basis that 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.

76. YCEL has identified that the relevant expenditure attributable to the establishment of the vines is \$1,158. For a Grower entering into the Project, no amount will be allowable as a deduction for the years ended 30 June 1999 to 30 June 2001. YCEL projects that the first commercial season will be the year ended 30 June 2002 and the write-off will, therefore, commence in that year.

Alternative view

77. 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 use of the phrase 'or to hold it ready for use' under the relevant provisions and the acceptance of the use of the trellises for income producing purposes from the earlier time.

Section 42-15: depreciation expenditure of trellising

78. Growers accepted into the Project incur expenditure on trellising upon which the vines are attached and are to be used on their behalf in the operation of the vineyard business. This is attached to the land as a fixture. This expenditure is of a capital nature.

79. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

80. It is, however, 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 the Australian Taxation Office's (ATO's) views on this issue. Where a lessee is considered to own the improvements under a state law, as

detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

81. Under the Management Agreement, a Grower has the right to occupy certain land upon which they are entitled to grow vines to conduct a business of viticulture. The Management Agreement provides the Grower with an opportunity to remove the trellising at the end of the Project, unless the Improvements Option is exercised.

82. The Growers will use the trellising in producing income from grape sales. The depreciation deduction is calculated by reference to the effective life of the trellising. The depreciation deduction will be allowable from the day on which the trellising is installed. YCEL will advise Growers when the trellising is installed and first used for the purpose of producing assessable income.

Other capital costs

83. The applicant has provided no information regarding the nature of the \$70 per Vineyard Allotment that is included in the Subscription Fee and is described as being for 'other capital costs'. Accordingly, the deductibility or otherwise of this amount is outside the scope of this Ruling.

Interest deductibility

84. 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 rent 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. Thus, provided the qualifications in paragraph 52 are met, these fees will have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Assessable income

85. Gross sale proceeds derived from the sale of grapes harvested from the project will be assessable income of the Growers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the terms of the specific sale contracts entered into.

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Capital gains and losses

86. A change in the ownership of a capital asset is a CGT event for the purposes of Part 3-1 of the ITAA 1997. Under the terms of the Option Agreement, Ronlae can acquire ownership of the Grower's Improvements in two ways. Firstly, by a valid exercise of the Improvements Option. Secondly, where a Grower fails to, or chooses not to, validly exercise the Improvements Option and fails to, or chooses not to, remove the Grower's Improvements in accordance with the terms of the Option Agreement.

87. As a result of the CGT event occurring, a capital gain or loss may arise. For the purposes of determining whether a capital gain or loss arises, where Ronlae acquires the Grower's Improvements for no consideration because a Grower fails to, or chooses not to, validly exercise the Improvements Option, section 116-30 provides that the Grower will be taken to have received market value for the Grower's Improvements.

88. If a capital gain arises, the amount of that capital gain will form part of the Grower's assessable income. If a capital loss arises, the amount can only be offset against capital gains arising in the same year or in future years.

Section 82KZM

89. Under the Management Agreement the rent and management fees of \$16,086 per Vineyard Allotment will be incurred upon entering into that Agreement. Fees and rentals are also payable for years 2 and 3 of the Project. These fees are charged for providing management services and lease of a Vineyard Allotment to a Grower. For this Ruling's purposes, no conclusion can be drawn from the arrangement's description that any part of these fees have been inflated to result in reduced fees being payable for subsequent years. The fees are expressly stated to be for a number of specified services. There is no evidence that might suggest the services covered by the fee in any particular year will 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 fees for Years 1 to 3 are for YCEL 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 incurred by Growers in the first 3 years of the Project.

Section 82KL

90. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

91. An 'additional benefit' (see the definition of 'additional benefit' at 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.

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

Part IVA

93. 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). Yelloch Creek Estate Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deductions in respect of rental and management fees for each Vineyard Allotment and possible interest on borrowings, allowable under section 8-1, and deductions allowable under Subdivisions 387-B and 387-C, and sections 42-15 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.

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

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Commissioner of Taxation

16 June 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

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

Legislative references:

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- ITAA1936 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A

- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 318
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- ITAA1997 387-C
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Case references:

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

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ATO references:

NO 99/2154-1

BO

FOI index detail: I 1019989

ISSN: 1039-0731

Price: \$2.40