



PR 1999/31 - Income tax: Australian Blue Gum Project 1999

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Product Ruling

Income tax: Australian Blue Gum Project 1999

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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 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 Australian Blue Gum Project 1999, or 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are section 8-1 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 'Growers'.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the

arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 26) 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 19 May 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 2000. 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:

- Prospectus issued for Australian Blue Gum Project 1999; dated 22 March 1999, including **Application For A Lease And Management Agreement**, Terms of Finance From The Financier (Western Forest Finance Pty Ltd) and **Power Of Attorney**;
- **Lease and Management Agreement** between Australian Blue Gum Management Limited ('ABGM', or the 'Responsible Entity') and the Grower;
- Constitution of the Managed Investment Scheme known as the 'Australian Blue Gum Project', dated 15 March 1999;
- Technical Advice Agreement between ABGM and Independent Forestry Services Pty Ltd, dated 19 March 1999;
- Administration Services Agreement between ABGM and Pacific Forest Financial Services Pty Ltd, dated 22 March 1999; and
- Custodian Agreement between ABGM and Charters Securities Limited ('Custodian'), dated 4 March 1999.

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

13. The documents highlighted are those the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, that a Grower, or any associate of a Grower, will be a party to, that are part of the arrangement to which this Ruling applies. The effect of the agreements listed above is summarised as follows.

14. This arrangement is called the Australian Blue Gum Project 1999. Growers entering the Project will sublease land from ABGM in either the south west of Western Australia or in an area known as the 'Green Triangle Region' in south east South Australia and western Victoria. The Growers will also contract with ABGM under the Lease and Management Agreement, to have *eucalyptus globulus* (Tasmanian Blue Gum trees) planted on their leased land for the purpose of eventual felling and sale in approximately ten to eleven years.

15. There are 1,000 'Leased Areas' on offer of 1 hectare each, at a cost of \$2,500 per Application plus \$2,400 for each Leased Area applied for, although ABGM has the right to accept oversubscriptions. A minimum of 1,000 trees per hectare will be planted within the first 13 months, following execution of the Lease and Management Agreements. There is no minimum subscription level. However, Applications will not be accepted and Subscription Monies will be refunded if there is insufficient land available.

16. Possible projected returns for the Project depend on a range of assumptions and ABGM does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Lease and Management Agreements in question. Based on the examples set out on pages 10 and 11 of the Prospectus, a Grower could expect to achieve compound pre-tax returns indicative of their proceeds from sale of their timber exceeding their expenses under the Lease and Management Agreement.

Lease and Management Agreement

17. Under the Lease and Management Agreement ('LMA'), Growers enter into a 12 and a half year lease for one or more Leased Areas, and contract with ABGM to establish and maintain the plantation until maturity. Clause 3 of the LMA grants an interest in the land to the Grower and an interest in the trees grown on their behalf. Growers are not entitled to assign their rights under the LMA, except in certain circumstances (cl 13.3, LMA and cl 19 of the Constitution). Certificates are issued to Growers. ABGM keeps a register of Growers (cl 13.4, LMA). Growers execute a power of

attorney enabling ABGM to act on their behalf as required (cl 4.4, LMA). Growers may elect to harvest their own timber produce (cl 3.3, LMA), or have ABGM, acting as their agent, harvest and sell the timber produce on the Grower's behalf, for the best possible commercial price (cl 10, LMA).

Fees

18. The total initial fees payable under the Lease and Management Agreement in respect of the period commencing upon execution of the Agreement and ending within 13 months thereafter are \$2,500 per Application plus \$2,400 for each Leased Area applied for, and rent of \$220 per Leased Area.

19. The Independent Forester states, at page 30 of the Prospectus, that the costs and charges to Growers '... are reasonable and comparable with those investments in similar forestry projects in Australia.'

20. The Application Monies will be banked into the Application Fund formed under the project's Constitution (cl 3 of the Constitution). These monies will be released from the trust account to the Responsible Entity when certain specified criteria have been met (cls 7 and 8 of the Constitution).

21. In subsequent years Growers will be charged \$220 (CPI indexed) rent per Leased Area and \$85 (CPI indexed) maintenance fee. In addition, a Harvest Royalty of 4% of the Total Proceeds, to cover harvest costs is payable (rising to 5% if the yield from the Plantation exceeds 250 cubic metres per hectare).

Planting

22. During the period commencing on execution of the Lease and Management Agreement (for acceptable Applications received up to 30 June 1999, this will be on or before 30 June 1999), and ending within 13 months thereafter, ABGM will be responsible for planting *eucalyptus globulus* on the Leased Areas. From this period on, ABGM will maintain the trees in accordance with good silvicultural practice. The services to be provided by ABGM over the term of the Project are defined in clauses 5.2 and 5.3 of the LMA. Clause 3.3(c) of the LMA provides that the Grower shall have the right to harvest, market and sell the timber grown on their Leased Area, but not to any coppice after the first harvest.

23. ABGM may, if the Grower so chooses, also be responsible for arranging the marketing and sale of the timber produce. ABGM will provide ongoing reports to the Growers on the progress of the plantation. ABGM will subcontract certain plantation establishment

and maintenance functions to Independent Forestry Services Pty Ltd, a related company.

24. Growers who choose ABGM to market and sell the timber, authorise ABGM to consolidate the trees on their Leased Areas, for the purposes of marketing and sale. The proceeds of sale net of the Harvest Royalty and other costs (e.g., logging, processing, transportation, etc.) will be paid to those Growers in proportion to their respective Proportional Interests.

Finance

25. Growers can choose to fund their investment themselves, borrow from an unassociated lending body or borrow through special finance arrangements offered by a financier related to ABGM, Western Forest Finance Pty Ltd ('WFFPL'). Two finance options are offered in this last respect:

Option A: interest free, promissory note finance

- \$720 deposit for one Leased Area
- 11 equal monthly instalments of \$400 for one Leased Area, by periodical debit

Option B: principal and interest finance to suitably qualified applicants

- 30% deposit (with a minimum loan principal under this option of \$15,600, i.e., minimum of 5 Leased Areas required)
- 36 equal monthly repayments
- interest rate currently 9.5% fixed.

26. Under both options ABGM is to be put in funds by the financier as and when the monthly repayments are due by the Grower. Both options involve full recourse loans and WFFPL will pursue legal action against defaulting borrowers. Finance arrangements organised directly by Growers with lenders are outside the arrangement to which this Ruling applies.

Ruling

Section 8-1

27. For the years ending 30 June 1999 and 30 June 2000 section 8-1 will apply to Growers entering this Project as follows:

- to allow a deduction of \$5,120 (including rent of \$220) per one (1) Leased Area, incurred on execution of the Lease and Management Agreement on or before 30 June 1999, for the year of income ending 30 June 1999; or
- to allow a deduction of \$5,120 (including rent of \$220) per one (1) Leased Area incurred on execution of the Lease and Management Agreement on or before 30 June 2000, for the year of income ending 30 June 2000; and
- to allow a deduction for interest incurred in respect of Option B, during the years ending 30 June 1999 and/or 30 June 2000, for those years.

Sections 82KZM, 82KL and Part IVA

28. For a Grower who invests in the Project, the following provisions have application as indicated:

- the expenditure by Growers does not fall within the scope of section 82KZM of the ITAA 1936;
- section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in 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

29. Consideration of whether lease 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 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.

30. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the timber's sale from the scheme will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

31. Generally, an investor will be carrying on a business of afforestation where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the timber;
- the afforestation activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

32. For this Project Growers have, under the Lease and Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Lease and Management Agreement Growers appoint ABGM, as Responsible Entity, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers are considered to have control of their investment. The specific cost to the Grower of these services provided in the first thirteen months will total \$4,900. Growers may either collect the forest produce and arrange for its sale themselves or they have the option of ABGM arranging marketing and sale.

33. The Lease and Management Agreement gives Growers full right, title and interest in the timber produce and the right to have that produce sold for their benefit. The Project documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees belong to the Growers in the sense that they have an interest in the land on which they are growing and a *profit à*

prendre in respect of the timber produce, which confers an equitable interest in the trees upon the Grower.

34. Growers have the right to use their Leased Areas for afforestation purposes and to have ABGM come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over ABGM, as evidenced by the Agreement and supplemented by Corporations Law, is sufficient. Under the Project documentation, Growers are entitled to receive regular progress reports on ABGM's activities. Growers are able to terminate arrangements with ABGM in certain instances, such as cases of default or neglect. The afforestation activities described in the Lease and Management Agreement are, therefore, carried out on the Grower's behalf.

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

36. Growers will engage the professional services of a Responsible Entity with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

37. Growers have a continuing interest in the trees from the time they are acquired until harvest. The afforestation 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' afforestation activities will constitute the carrying on of a business.

38. The fees associated with the afforestation 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 timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

39. The liability for initial lease and management fees arises from the execution of the Lease and Management Agreement. This liability is to be discharged in the year of income it is created. This is not a

case to which we would apply the 'properly referable' principle set out in *Coles Myer Finance Ltd v. FCT* (1993) 176 CLR 640; 93 ATC 4214; (1993) 25 ATR 95.

Section 82KZM

40. Under the Lease and Management Agreement the fee of \$5,120 per one (1) Leased Area will be incurred on execution of that Agreement. This fee is charged for providing services and use of land to a Grower only for a maximum period of 13 months from the execution of the Agreement. The fee is expressly stated to be for a number of specified services. 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 years. There is also 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, it can be accepted that no part of the fee of \$5,120 is for ABGM doing 'things' that are not to be wholly done within 13 months of the 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 expenditure by Growers of \$5,120 per Leased Area.

Section 82KL

41. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by WFFPL to the Grower. The loan is provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

42. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme' commencing generally on the date when the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of \$5,120 per one (1) Leased Area, allowable under section 8-1, 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.

43. 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 trees. Further, there are no features of the Project, for example, such as the lease and management fees of \$220 and \$4,900 being ‘excessive’, and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient ‘real money’ coming into the Responsible Entity’s hands, that might suggest the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude, that would attract the operation of Part IVA.

Interest deductibility

44. Some Growers 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 lease and management fees of \$5,120 per one (1) Leased Area are deductible. The interest fees will be in respect of a loan to finance the operations - the planting, tending, maintenance and harvesting of the trees - that 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

19 May 1999

Previous draft:

No draft issued

- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- timber industry

*Related Rulings/Determinations:*PR 98/1; TR 92/1; TR 97/11;
TR 97/16; TD 93/34*Subject references:*

- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- interest expenses
- management fees expenses
- plantation forestry
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams

Legislative references:

- ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 8-1

Case references:

- *Coles Myer Finance Ltd v FCT* (1993) 176 CLR 640; (1993) 25 ATR 95; 93 ATC 4214

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