

PR 2000/22 - Income tax: Tiwi Islands Acacia Project No. 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 April 2000*



Product Ruling

Income tax: Tiwi Islands Acacia Project No. 2

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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 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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 Tiwi Islands Acacia Project No. 2, or just simply as 'the Project', or the 'product'.

Tax Law(s)

2. The tax laws that are dealt with in this Ruling are:

- Section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 25-25 (ITAA 1997);
- Section 27-5 (ITAA 1997);
- Section 27-30 (ITAA 1997);
- Subdivision 960-Q (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Sections 82KZM, 82KZMA, 82KZMB, 82KZMC and 82KZMD (ITAA 1936); and
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant laws are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law are enacted, the Commissioner will formalise the non-binding information shown in the Ruling by issuing a new Product Ruling that describes the operation of those laws.

Class of persons

6. 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'.

7. 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

8. 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

10. This Ruling applies prospectively from 22 March 2000, 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).

11. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the product ruling

applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2001. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

13. The arrangement that is the subject of this ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Letter of Application for Product Ruling dated 24 January 2000;
- Draft Prospectus in respect of the 'Project';
- Draft Deed of Constitution dated 21 January 2000 establishing the Project;
- **Draft Licence and Management Agreement** between First Management Corporation ('FMC') and the Grower;
- Draft 'Agreement to Sub-Lease' between Australian Plantation Group Limited and FMC;
- Head Lease between the land owner and Australian Plantation Group dated 16 September 1999;
- Form of Long Term Loan Agreement between First Investment Corporation Limited ('FIC') and the Grower; and
- Form of Short Term Loan Agreement between FMC and the Grower.

Note: Certain information received from First Management Corporation Limited has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information Legislation.

14. The document described in bold in paragraph 13 is one the Growers will enter into. The Grower may also enter into a Short Term (or a Long Term) Loan Agreement with FMC. The effect of these agreements is summarised as follows.

Overview

15. The arrangement is called Tiwi Islands Acacia Project No 2.

Location	Melville Island, one of the Tiwi Islands in the Northern Territory of Australia, 60 km north of Darwin.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Acacia mangium</i> trees for the purpose of producing woodchip or other suitable timber products.
Number of hectares under cultivation	2,500 hectares offered under this prospectus, with provisions for oversubscription.
Name used to describe the product	Tiwi Islands Acacia Project No 2.
Size of the leased area	1 hectare
Number of trees per hectare	Approximately 1,111.
Expected production	300 m ³ /hectare
The term of the project	6.5 - 7 years
Initial cost per leased area	\$6,000
Initial cost on a per hectare basis	\$6,000
Ongoing costs per leased area	No annual costs. Final fee of 10% of net harvest proceeds.

16. The date a Grower lodges an application determines the date of execution of the Licence and Management Agreement and the period of provision of establishment services to which the initial fee relates. The two relevant periods are summarised as follows:

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Application lodged	Stage	Date Application is Accepted	Fee per leased area	Period of provision of establishment services and eligible service period
On or before 16/6/2000	Pre-30 June 2000 Stage 1	On or before 16/6/2000	\$4,900	From date of execution of Licence and Management Agreement to 30/6/2000
	Pre-30 June 2000 Stage 2	On or before 16/6/2000	\$1,100	From 1 July 2000 to 30 June 2001(but not later than 13 months from date of acceptance of Grower's application).
Post 16/6/2000	Post 30 June 2000 Stages 1&2	At any time between 1/7/2000 and 30 June 2001.	\$6,000	From date of execution of Licence and Management Agreement to 30/6/2001

17. Growers will be invited by way of prospectus to acquire an interest in the Project.

18. Growers entering into the Project will receive a licence ('**Licence**') of land from FMC on the Tiwi Islands in the Northern Territory, this land having been sub-leased to FMC by Australian Plantation Group Limited (APG) under the 'Agreement to Sub-Lease'.

19. The landowner will lease the land to APG and will consent to APG subleasing the land to FMC (the responsible entity for the Project).

20. The Growers will enter into a Licence and Management Agreement with FMC under which they will be granted a Licence and will have *Acacia mangium* seedlings planted on their licensed land for eventual felling and sale, approximately 6.5 years after establishment.

21. There are 2,500 Plantation Lots (1 hectare each) on offer with provision for oversubscription. There is no minimum number of Plantation Lots that may be licensed by each Grower. Approximately 1,111 trees per Plantation Lot will be planted following the execution of the Licence and Management Agreement. Minimum subscription of 200 lots will be reached no later than 31 May 2000.

22. A Grower can fund the payment of \$6,000 (plus any GST) per Plantation Lot from their own resources. Alternatively, a Grower may arrange their own finance to make some or all of the payments of \$6,000 per Plantation Lot. Alternatively, Growers may obtain finance in the manner described in paragraph 38.

Licence and Management Agreement

23. Under the Licence and Management Agreement, Growers enter into a Licence for one or more Plantation Lots. Growers will contract with FMC to establish and maintain the plantation until maturity and to harvest and sell the wood on their behalf.

24. Afforestation activities will be carried out on Growers' behalf during the Initial Term. The Initial Term is divided into two Stages – Stage 1 and Stage 2.

25. Where a Grower enters into a Licence and Management Agreement not later than 16 June 2000 (referred to as a '**Pre-30 June 2000 Grower**'), clause 9.3 of the Licence and Management Agreement will require the Manager to perform the Stage 1 Services in respect of that Grower's Plantation Lot(s) on or before 30 June 2000. The balance of the services, referred to as Stage 2 Services, will be required to be performed before the end of the Grower's Initial Term (see paragraph 29). The Manager will stop accepting applications for Pre-30 June 2000 Growers at close of business on 16 June 2000, and the Manager will not accept any applications between 17 June 2000 and 30 June 2000. Any applications received by the Manager during that period will only be accepted after 1 July 2000.

26. The amount of the Plantation Establishment Fee that relates to the Stage 1 Services (the '**Stage 1 Amount**') is \$4,900 per Plantation Lot, \$177 of which relates to land clearing services. The balance of \$1,100 per Plantation Lot (the '**Stage 2 Amount**') relates to the balance of the services to be performed during Stage 2.

27. The total afforestation activities will be substantial and will be undertaken in a businesslike manner on a regular basis for and on behalf of each Grower. The services provided by FMC include:

- The acquisition of *Acacia mangium* seedlings on each Grower's behalf;
- Cultivating, maintaining, fertilising, watering, spraying, pruning, thinning out and doing all other things necessary to the trees to produce mature trees;
- Keeping down and exterminating upon the land all vermin and animal pests, insects and noxious plants and weeds, and complying with all laws and regulations with respect to the keeping down and exterminating of the same;
- Arranging the insurances referred to in the Licence and Management agreement including tree insurance at the Grower's option;

- Employing such staff and labour as are necessary for the aforesaid purposes including, without limitation, engaging the services of such consulting experts as may be necessary to assist the Manager in providing expert advice and assistance with respect to the growing of the trees;
- Providing adequate security for the land including, without limitation, constructing and maintaining security fences and fire breaks;
- Provide adequate drainage to prevent and combat soil degradation;
- Performing any of the duties of the Manager as required under the Licence and Management Agreement and the Constitution;
- Land clearing; and
- Doing all other things that are necessary or incidental to the carrying out of the Grower's business to produce a viable business of growing of *Acacia mangium* trees for wood-chipping or other suitable purposes.

28. The Manager will perform the Stage 1 Activities between acceptance of a Pre-30 June 2000 Grower's application and the end of Stage 1 (30 June 2000). All Stage 1 activities, except for land clearing services, will be provided after a Grower's application is accepted by the Manager.

Fees

29. Under the Licence and Management Agreement, a fee of \$6,000 plus any applicable GST per Plantation Lot (the '**Plantation Establishment Fee**') is payable in advance in return for both the Licence for the period between the Commencement Date and the finalisation of planting on a Plantation Lot which will occur before the earlier of 13 months after the Commencement Date or 30 June 2001 (the '**Initial Term**'), and for FMC purchasing the seedlings, land clearing, preparing the land for planting, planting the seedling trees and maintaining the Grower's Plantation Lot for the Initial Term.

30. Under the Licence and Management Agreement, a Grower shall be subject to a presently existing liability to pay the full amount of the Plantation Establishment Fee upon execution.

31. After the Initial Term, a further fee (the '**Final Fee**') plus GST is payable at maturity of the Project in consideration for the licence and management services provided by FMC for the balance of the Licence and Management Agreement. That Final Fee will be the sum

of an amount equal to 10% of the Net Harvest Proceeds and an amount equal to 33.33% of the amount by which the actual Net Harvest Proceeds exceed the Net Harvest Proceeds projected in the Prospectus.

32. Other charges include tree insurance policy premiums which are available at the Grower's option.

33. FMC will hold all of the Fees received by it from the Growers in bank deposits or government or semi-government securities and debentures and investments in short term money markets for the Initial Term, and will draw on those funds as required to meet its obligations under the Licence and Management Agreement.

Land clearing

34. Land clearing expenditure of \$177 per Plantation Lot will be incurred out of the \$4,900 Stage 1 Amount per Plantation Lot. The land clearing expenditure comprises:

- \$138 per Plantation Lot for chaining; and
- \$39 per Plantation Lot for burning the felled trees.

Planting

35. During the Initial Term, FMC will be responsible for planting the *Acacia mangium* trees. FMC will maintain the trees in accordance with good silvicultural practice. FMC will be responsible for arranging the sale, hauling, loading and transporting of trees. FMC is entitled to sell the trees on the stump rather than as cut logs. The harvest period is no earlier than 6.5 years and no later than 9.5 years after the Commencement Date.

36. FMC may engage Sylvatech Australia Pty Limited and/or other consultants as required.

37. FMC will arrange for the sales of the trees prior to maturity and will use its best endeavours to obtain the maximum price available for the Growers. FMC will account to each Grower for the gross proceeds of the sale to which the Grower is entitled, after having deducted the Final Fees payable by the Grower in arrears.

Finance

38. Growers will have the following financing options in respect of payment of the Plantation Establishment Fee:

- (a) **Cash Option** (no finance) – under this option, Growers shall satisfy their liability to pay the full amount of the

Plantation Establishment Fee in cash on execution of the Licence and Management Agreement.

- (b) **Long Term Loan Option** – under this option, Growers shall borrow an amount equal to the Plantation Establishment Fee from a lending institution on its usual terms for full recourse personal loans. The lender will exercise all of its legal rights against any defaulting Grower. (The loan would be repayable over a period to be agreed between the Grower and the lender). The Manager will not provide the lender with any security in respect of the loan to the Grower.

FIC, a group company of FMC, may be one of the finance companies which provides loans to Growers on the terms set out in the Long Term Loan Agreement referred to in paragraph 13.

All of these lending arrangements will be subject to the following conditions:

- (i) all loan terms will be of an arm's length nature;
 - (ii) borrowers will remain fully liable for the balance of the loan outstanding at any time and lenders will take legal action against defaulting borrowers;
 - (iii) there will be no right to assign;
 - (iv) there will be no 'round robin' characteristics;
 - (v) there will be no split loan features of a type referred to in Taxation Ruling TR 98/22;
 - (vi) there will be no indemnity arrangements or any other collateral agreements in relation to the loan; and
 - (vii) repayments of principal and payments of interest will not be linked to derivation of income from the Project.
- (c) **Short Term Loan Option** (instalment option) – under this option, Growers will borrow an amount equal to the Plantation Establishment Fee from the Manager on terms set out in the Short Term Loan Agreement referred to in paragraph 13. The loans provided under this Short Term Loan Agreement will be on an interest-free basis and be subject to the following conditions:
- (i) The loan will be repayable by one of the following repayment options:

- Pre 30 June 2000 Growers must repay the borrowed amount as follows: an agreed percentage is repayable in equal monthly instalments on or before 30 June 2000 (e.g. if a Grower enters into a Licence and Management Agreement on 1 April 2000, and agrees to pay 50% by 30 June 2000 they must pay 3 monthly instalments of \$1,000 each per Plantation Lot) and the balance is repayable in twelve equal monthly instalments between July 2000 and June 2001 (inclusive);
 - Post 30 June 2000 Growers must repay the borrowed amount in full on or before 30 June 2001;
- (ii) A loan application fee of \$300 per application will be payable by Growers who take this finance option;
 - (iii) The election to repay the loan by instalments will nevertheless involve the Grower paying the Plantation Establishment Fee in full on commencement. The Grower will be liable to repay to the Manager the monies borrowed. The Manager's rights of recourse against the Grower will not be limited in any way;
 - (iv) The Manager will exercise all of its rights to recover any unpaid instalments of loan principal (which would include taking legal action against investors who default in their instalment payments); and
 - (v) The loans, from the Manager, Growers enter into will satisfy the following conditions:
 - 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 the lender will take legal action against defaulting borrowers;
 - there will be no right to assign;
 - there will be no 'round robin' characteristics;

- there will be no split loan features of a type referred to in Taxation Ruling TR 98/22;
- there will be no indemnity arrangements or any other collateral agreements in relation to the loan; and
- repayments of principal will not be linked to derivation of income from the Project.

39. Growers may incur various borrowing costs within the meaning of section 25-25.

Ruling

Goods and Services Tax

40. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Allowable deductions

41. For a Grower who invests in the Project, the deduction available for the prepaid Licence and Management Fee will depend upon the date that the investment is made.

IMPORTANT: Paragraph 42 (relating to 'small business taxpayers') and paragraphs 43 to 47 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 50 and 51 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

42. For a Grower who is a 'small business taxpayer' and invests in the Project before 30 June 2000, the deductions shown in the Table below will be available for the years ended 30 June 2000 to 30 June 2001.

Fee type	<i>ITAA</i> 1997 Section	Deductions for small business taxpayers only	
		Year 1	Year 2
		30/6/2000	30/6/2001
1.Plantation Establishment fee-pre-30 June 2000 Grower'	8-1	\$5823 – see Note (i) below	
2.Plantation Establishment fee-'post-30 June 2000 Grower'	8-1		\$5823

Notes:

- (i) Legislative change for Growers who are not 'small business taxpayers' means the full deduction will not be allowed in 2000. See paragraphs 43 to 47 and Example 1. Proposed legislative change for all Growers applying to expenditure incurred after 11 November 1999 means the full deduction will not be allowed in 2000. See paragraphs 50 and 51 and Example 2.

43. For a Grower who invests in the Project on or before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deduction allowable in respect of the Stage 2 amount of the Plantation Establishment Fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 at paragraph 86 illustrates the application of this method).

Fee type	ITAA 1997 Section	Deductions for non small business taxpayers only	
		Year 1	Year 2
		30/6/2000	30/6/2001
1.Plantation Establishment Fee - Stage 1 'pre- 30 June 2000 Grower'	8-1	\$4723 – see paragraph 45 below	
1. Plantation Establishment Fee - Stage 2 'pre- 30 June 2000 Grower'	8-1	\$880 – see paragraph 46 below	\$220 - see paragraph 47 below
2.Plantation Establishment fee- 'post-30 June 2000 Grower'	8-1		\$5823

44. In calculating the deduction available, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 for which the 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

Year 1: Expenditure incurred on or before 30 June 2000

Available deduction = A + B

Where :

Number of days of eligible service
period in the expenditure year

A = Expenditure X $\frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$

B = (Expenditure less A) x 80%

45. As set out in paragraph 16, the 'eligible service period' for the Stage 1 Amount, incurred by Pre-30 June 2000 Growers, is wholly inclusive in the year ended 30 June 2000. Using the formula above, the Stage 1 Amount, excluding \$177 land clearing expenditure, is wholly allowable (\$4723).

46. The 'eligible service period' for the Stage 2 Amount, incurred by Pre-30 June 2000 Growers, is wholly inclusive in the year ended 30 June 2001. Using the formula, the amount of the Stage 2 deduction allowable for the year ended 30 June 2000 is A+B where:

$$A = \$1100 \quad X \quad \frac{0}{365}$$

$$A = \$0$$

$$B = (\$1100 - \$0) X 80\%$$

$$B = \$880$$

That is, the amount of the stage 2 deduction allowable for the year ended 30 June 2000 will be \$880.

47. A deduction for the balance of the Stage 2 expenses(\$220), for the Pre-30 June 2000 Growers, will be allowable for the year ended 30 June 2001.

Section 25-25

48. For a Grower who invests in the Project, section 25-25 will apply to allow a deduction for any loan application fees payable to a lender, where the loan satisfies the conditions in paragraph 38, over the period of the loan or 5 years, whichever is the lesser.

Sections 82KZM, 82KZMB, 82KL and Part IVA

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

- expenditure by Growers who are small business taxpayers is not within the scope of section 82KZM **(but see paragraphs 50 to 52)**;
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business **(but also see paragraphs 50 to 52)**;
- section 82KL 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.

Proposed new laws

Proposed changes to prepayment rules

50. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999, will be subject to these changes.

51. For these Growers the amount of deduction allowable in respect of the Licence and Management Fee will be calculated using the formula in subsection 82KZMB:

$$\text{Deduction} = \text{Expenditure} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

The excess remaining after the application of this formula would be deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers -

52. Product rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Australian Taxation Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of 'tax shelter' arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Explanations

Sections 27-5 and 27-30 - Goods and Services Tax

53. Section 27-30 of the ITAA 1997 operates to deny a deduction that would be otherwise available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

54. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Grower has.

Subdivision 960-Q - Small business taxpayers

55. In this product ruling the term 'small business taxpayer' is relevant for the purposes of prepaid licence and management expenditure.

56. Whether a Grower is a 'small business taxpayer' depends upon the individual circumstances of each Grower and is beyond the scope of this product ruling. It is the individual responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

57. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

58. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

Sections 8-1

59. Consideration of whether the Plantation Establishment Fee is 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 before the business has commenced; and
- where all that happens in a year of income is a taxpayer contractually commits itself 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 deductions are allowable under the second limb. However, that does not preclude the application of the first limb in determining whether the

outgoings in question have a sufficient connection with the activities to produce assessable income.

60. 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 sale of trees from the scheme will constitute gross assessable income. 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.

61. Generally, a Grower will be carrying on a business of afforestation where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the trees;
- the afforestation activities are carried out on the Grower'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.

62. For this Project Growers have, under the Licence and Management Agreement, rights in the form of a Licence over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Licence and Management Agreement, Growers receive a licence to use Plantation Lots and appoint FMC, as Manager, to provide services such as planting, cultivating, tending, fertilising, replanting, maintaining and otherwise caring for the trees according to good silvicultural practice.

63. The Licence and Management Agreement gives Growers more than a chattel interest in the timber on harvest. The documentation contemplates the Growers will have an ongoing interest in the growing trees – the trees are the Growers' property and Growers have an interest in the land.

64. The Licence and Management Agreement gives Growers property rights in trees, the full right, title and interest in the products and the right to have the products sold for their benefit until the end of the arrangement.

65. Growers have the right to use the land in question for afforestation purposes. They appoint FMC to perform the services specified in the Licence and Management Agreement. The Growers' degree of control over FMC, as evidenced by the Licence and Management Agreement and supplemented by the Corporations Law,

is sufficient to establish that the activities are carried out on behalf of Growers. Under the Project, Growers are entitled to receive regular progress reports on the state of the tree crop and FMC's activities. Growers are able to terminate arrangements with FMC in certain instances, such as where the Manager fails to perform its services in a proper or efficient manner. The afforestation activities described in the Licence and Management Agreement are carried out on the Growers' behalf.

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

67. Growers will engage the professional services of a Manager 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.

68. 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.

69. The Plantation Establishment Fees, to the extent of \$5,823 (exclusive of GST) per Plantation Lot associated with the afforestation activities for the Initial Term, 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 trees) is to be gained from this business. They will, thus, be deductible under the first limb of section 8-1. The tests of deductibility under the first limb of section 8-1 are met to the extent of \$5,823 per Plantation Lot. A capital component to the extent of \$177 per Plantation Lot is identifiable and is excluded from deductibility under section 8-1.

Interest Deductibility

70. Some Growers may finance the investment through a loan. Whether the interest is deductible under section 8-1 depends on the same reasoning as that applied to whether the Plantation Establishment Fee will be deductible.

71. The interest incurred on the loan during the years ended 30 June 2000, 30 June 2001 and 30 June 2002, will be in respect of a loan to finance the Grower's operations – the tending, maintenance and harvesting of the trees, and the licence of the land on which the trees will have been planted – that will continue to be directly connected with the gaining of 'business income' from the Project. The interest will, thus, also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of it.

Section 25-25

72. Any loans obtained by Growers will be provided on a full recourse basis and on commercial terms for the purpose of producing assessable income. On this basis, section 25-25 will apply to allow a deduction over the period of the loan for the expenditure incurred in borrowing funds to fund the obligations to pay the Plantation Establishment Fees.

Expenditure of a Capital Nature

73. Any part of the expenditure of Growers entering into an afforestation business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital in nature and will not be an allowable deduction under section 8-1. In this Project the costs of land clearing are capital in nature. The fees for these expenditures are not deductible under section 8-1.

74. The Manager has identified the relevant expenditures that are of a capital nature. Growers entering into the Project incur and pay an amount of \$177 per Plantation Lot for land clearing which is capital in nature.

Section 82KZM - Prepaid expenditure for small business taxpayers

75. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

76. Under the Licence and Management Agreement, the Plantation Establishment Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of

no more than 13 months from the date of execution of the Agreement. For this Ruling's purposes, 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. The fee is expressly stated to be for a number of specified services. There is evidence this fee is for services to be provided within 13 months of the fee being incurred.

77. Thus, for the purposes of this Ruling, it is accepted that no part of the Plantation Establishment Fee is for the Manager to do '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 for the Plantation Establishment Fee by Growers who are 'small business taxpayers'.

Sections 82KZMA - 82KZMD - Prepaid expenditure for taxpayers other than small business taxpayers

78. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

79. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project, transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was occurred, and does not apply to the Project.

80. The deduction allowable to Growers for the Plantation Establishment Fee will be determined in accordance with the rules contained in section 82KZMB

81. During the transitional period the amount of the deduction available to Growers is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

82. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. Under this proposal deductions otherwise allowable under section 8-1 of the ITAA 1997 would be spread over the period to which the prepayment relates (refer paragraph 16). Moreover, there would be no exemption for small business taxpayers and no transitional rules will apply.

83. A tax shelter arrangement is described as existing where:

- under the arrangement, the taxpayer's allowable deductions exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g., a manager) other than the taxpayer; and
- either:
 - more than one taxpayer participates in the arrangement; or
 - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

84. The arrangement relating to the Project and described at paragraphs 13 to 39 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Plantation Establishment Fee, for Stage 2 services, incurred by Pre-30 June 2000 Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for this apportionment is expected to be the same as that currently shown in subsection 82KZMD(2).

Section 82KL

85. 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 a lender to the Grower. Any such loan is to be provided on a full recourse basis and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

86. 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 when the Prospectus is issued. The Growers will obtain an initial 'tax benefit' from entering into the scheme, in the form of the deduction for the Plantation Establishment Fee of \$5,823 per Plantation Lot, the interest on any loan and any loan application fees 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 these tax benefits.

87. 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. There appears to be no specific indication of features of the Project 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.

Examples

88. Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 11 November– applies to taxpayers who are not small business taxpayers and are carrying on a business:

Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of \$4,899 for expenditure incurred before 30 June 2000 on management fees. This amount is calculated as A + B where:

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$$\begin{array}{r}
 \text{A} = \text{Management fee} \quad \text{X} \quad \frac{\text{Number of days of eligible} \\ \text{service period in the expenditure} \\ \text{year}}{\text{Total number of days of the} \\ \text{eligible service period}} \\
 \\
 = \$6,000 \quad \text{X} \quad \frac{30}{365} = \$493
 \end{array}$$

$$\begin{array}{l}
 \text{B} = (\text{Management fee less A}) \quad \text{X} \quad 80\% \\
 = (\$6,000 - \$493) \quad \text{X} \quad 80\% = \$4,406
 \end{array}$$

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e. \$1,101) is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of \$1,861 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$$\text{A} = \$1,200 \quad \text{X} \quad \frac{30}{365} = \$99$$

$$\text{B} = (\$1,200 - \$99) \quad \text{X} \quad 60\% = \$661$$

$$\text{C} = \$1,101$$

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the \$1,200 management fees prepaid on 1 June 2001 (i.e., \$440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, for 2001/2002, Joseph can claim a deduction of \$980 for expenditure incurred after 1 July 2001 and before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$\text{A} = \$1,200 \quad \text{X} \quad \frac{30}{365} = \$99$$

$$\text{B} = (\$1,200 - \$99) \quad \text{X} \quad 40\% = \$441$$

$$\text{C} = \$440$$

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the \$1,200 management fees prepaid on 1 June 2002 (i.e. \$660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

89. Example 2: Obligation arising on or after 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':

Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a 'tax shelter arrangement'. For the Management fee of \$6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$\$6,000 \times \frac{30}{365} = \$493$$

In the following year Joseph can claim the balance of the \$6,000 prepayment (ie \$5,507) because that is the year in which the services are to be provided. The second and third year's management fees are calculated using the same method.

Detailed contents list

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Related Rulings/Determinations:
PR 1999/95; TR 92/1; TR 97/11;
TR 97/16; TD 93/34; PR 1999/103

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

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- ITAA36 82KL
- ITAA36 82KL(1)
- ITAA36 82KZM
- ITAA36 82KZMA-82KZMD
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 8-1
- ITAA97 25-25
- ITAA97 27-5
- ITAA97 27-30
- ITAA97 960-Q
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- ITAA97 960-340
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