



# ***PR 2000/61 - Income tax: Forestry Tasmania Trees Trust 2000***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *17 May 2000*



## Product Ruling

### Income tax: Forestry Tasmania Trees Trust 2000

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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.

#### *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**, **Previous Rulings**, **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.*

#### **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.

## 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 Forestry Tasmania Trees Trust 2000, or just simply as 'the Project'.

### 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 (ITAA 1997);
  - section 27-5 (ITAA 1997);
  - section 27-30 (ITAA 1997);
  - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - section 82KZM and sections 82KZMA - 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 the 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 law(s) 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(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

### 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, nor who otherwise do not intend to derive assessable income from it. Neither does it include persons nor entities who are associates, as that term is defined in subsection 82KH(1) of the ITAA 1936, of any of the entities involved in the arrangement.

### **Qualifications**

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

9. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

- the Ruling has no binding effect on the Commissioner as the arrangements entered into are not the arrangements ruled upon; and
- the Ruling will be withdrawn or modified.

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### **Date of effect**

11. This Ruling applies prospectively from 17 May 2000, the date the 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).

12. 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

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. 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 change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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

- Correspondence dated 13 March 2000, including the documents titled "Overview of the Scheme and Taxation Propositions" included with that correspondence;
- The Forestry Trees Trust 2000 Offer Document;
- Trust Deed between the Public Trustee of Tasmania and Forestry Tasmania;
- **Licence Agreement** between the Public Trustee of Tasmania and Forestry Tasmania;
- Final draft copy of **Services Agreement** between the Public Trustee of Tasmania and Forestry Tasmania, provided on 12 April 2000;
- **Proceeds Agreement** between the Public Trustee of Tasmania and Forestry Tasmania;
- **Funding Agreement** between the Public Trustee of Tasmania and Forestry Tasmania;
- Correspondence dated 12 April 2000 and 3 May 2000.

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

15. The documents highlighted are those the Growers enter into through the Public Trustee of Tasmania with Forestry Tasmania. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to. The effect of these agreements is summarised as follows.

### Overview

16. This arrangement is called the Forestry Tasmania Trees Trust 2000:

Location	Tasmania - land owned or controlled by Forestry Tasmania.
Type of business each participant is carrying on	Commercial growing, and cultivation of <i>eucalyptus globulus</i> and <i>eucalyptus nitens</i> trees for the purpose of producing timber for woodchipping and other suitable products.
Number of hectares under cultivation	A total of 800 hectares are offered in 2000 (400 hectares in Stage 1 and 400 hectares in Stage 2).
Names used to describe the product	Forestry Tasmania Trees Trust 2000.
Size of each Forestry Right	1 hectare
The term of the investment in years	10 years
Initial cost - per hectare	\$3,000 (plus GST)
Ongoing costs	Nil (some costs will be recouped out of harvest proceeds - these are not likely to exceed \$300 per hectare).

17. Growers applying under the Offer Document enter into the Licence Agreement. This agreement provides for Forestry Tasmania to grant to each Grower a Forestry Right.

18. There is no minimum subscription for the Forestry Tasmania Trees Trust 2000. Applications made under the Offer Document will not be accepted after:

- 31 May 2000, in respect of Stage 1; and
- 29 September 2000, in respect of Stage 2.

19. Each investor may subscribe for a minimum of one hectare, at a cost of \$3,000 (plus GST) per hectare.

20. Possible projected returns for Growers are outlined on pages 52 and 53 of the Offer Document. The projected returns depend on a range of assumptions and Forestry Tasmania does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the arrangements.

## **Interest in Land**

21. Forestry Tasmania will grant an interest in land, being a Forestry Right, to the Public Trustee on behalf of the Growers under the terms of the Licence Agreement. The consideration for the grant of the Forestry Rights is 50% of the proceeds of timber grown by the Growers and the right on the part of Forestry Tasmania to take thinnings.

## **Services Agreement**

22. A Services Agreement is entered into between Forestry Tasmania and the Public Trustees on behalf of Growers.

23. Under the Services Agreement, if it is retained to provide services, Forestry Tasmania is contracted to provide Forestry Services to Growers. These services are:

- (i) where Growers elect to retain Forestry Tasmania to provide plantation establishment services, clearing and planting services; and
- (ii) where Growers elect to have Forestry Tasmania undertake the harvest, harvesting services.

24. Where Growers retain Forestry Tasmania to provide plantation establishment services, they must pay a fee of \$3,000 per hectare plus GST. In respect of Stage 1, the Services Agreement provides that \$2,000 is payable in respect of services to be provided no later than 30 June 2000, and \$1,000 is payable in respect of services to be provided after 30 June 2000 and no later than 31 December 2000. In respect of Stage 2, the Services Agreement provides that \$3,000 is payable in respect of services to be provided after 30 June 2000 and no later than 31 December 2000. Agreements in respect of Applications for Stage 2 received between 31 May 2000 and 30 June 2000 will not be executed until after 30 June 2000.

25. In practice, where the election is made to retain Forestry Tasmania, \$3,000 is paid to the Trustee together with the application to become a Grower, and the Trustee pays for the plantation establishment services in accordance with the Trust Deed. The purpose of these arrangements is to provide a mechanism whereby the Trustee can ensure that plantation establishment services are properly provided before payments are made to Forestry Tasmania. The second aspect of the Services Agreement is harvesting services. Growers may elect to have Forestry Tasmania harvest timber. If so, Forestry Tasmania will do so on the terms set out in the Services Agreement.

26. Growers are also able under the Services Agreement to give various directions to Forestry Tasmania.

### **Licence Agreement**

27. Under the Licence Agreement Forestry Tasmania grants Forestry Rights to the Public Trustee on behalf of the Growers. The Growers are at all times the owners of trees grown on the land.

28. The Forestry Rights granted to Growers entitle them to establish, maintain and harvest a crop of trees on land allocated to them. The Growers are also granted ancillary rights of access to and of constructing and using such facilities as may be necessary to establish, maintain and harvest that crop. The rights granted do not confer a right of exclusive possession of the land.

29. The area of land allocated to each Grower will be specifically identified by a grid showing 1 hectare squares superimposed over a plan of the area, and parcels of the appropriate number of squares randomly selected. Normally the Grower with the major area of each coupe will be allocated the parcel that remains following allocation to the other Growers. The boundaries of parcels will be locatable by reference to mapping co-ordinates shown on the plan. Appropriate records will be maintained by Forestry Tasmania, who will issue to the Trustee (on behalf of Growers) a certificate for each parcel of land allocated to a Grower. In addition to this certificate, Forestry Tasmania and the Trustee will arrange for the Forestry Rights to be registered in the name of the Trustee on behalf of the Growers.

30. The consideration paid to Forestry Tasmania for granting interests in the land and for the provision of pre-establishment services is:

- (i) 50% of the net proceeds of the timber harvested by the Grower on the land; and
- (ii) the right to take and sell thinnings.



## **Trust Deed**

31. Under the Trust Deed, the Trustee will hold the rights of the Growers under the Licence Agreement, Services Agreement and Proceeds Agreement.

32. The Trustee will also be involved in the process of receiving applications to become Growers and funds for Plantation Establishment Costs, should Growers elect to acquire the services of Forestry Tasmania for plantation establishment. The Trustee is obliged to hold these funds on trust for Growers, pending payment to Forestry Tasmania under the Services Agreement. The Trustee will also receive the net proceeds of harvest.

33. The Trustee will exercise Growers' rights under the various agreements, subject to directions given to the Trustee by Growers. The Trust Deed provides a mechanism for Growers to give directions to the Trustee in respect of the provision of funds or exercising rights under the various agreements.

34. The Trustee will arrange for a report known as the "Independent Forester's Report" to be provided to Growers one year after plantation establishment and a report from Forestry Tasmania audited by an Independent Forester five years after plantation establishment. The Trustee will arrange for further reports from Forestry Tasmania at the end of each additional five year period and six to nine months prior to harvesting. Growers can remove the Trustee.

## **Proceeds Agreement**

35. The returns from a single hectare of plantation forest timber are subject to risks such as fire, infestation and disease. Insurance is difficult to obtain and costly. The risk of loss of timber over an entire coupe (a growing area of 30-50 hectares) is much less than in respect of a single hectare of plantation forest. In order to reduce the risk of total loss of a crop, each Grower will agree with all of the other Growers in its coupe that returns be averaged over the coupe. Forestry Tasmania will be party to these arrangements, so that its one-half share of the proceeds of sale of timber in each Grower's hectare, plus timber grown by it on any "unallocated land" in a coupe will be increased or decreased accordingly.

## **Funding Agreement**

36. Under this agreement, Forestry Tasmania undertakes to fund Trustee's fees, the fees of the Independent Forester and any incidental GST charges, and is reimbursed out of the harvest proceeds.

**Fees**

37. Growers who elect to retain Forestry Tasmania to provide plantation establishment services in Stage 1 or Stage 2 will pay a fee of \$3,000 plus GST per hectare.

38. No other fees are payable by Growers, although certain expenses are recouped out of harvest proceeds. This initial fee is payable upon application to participate in the Project.

39. The application monies will be held by the Public Trustee under the terms of the Trust Deed and paid over to Forestry Tasmania when plantation establishment has been completed.

**Planting**

40. Planting of Stage 1 will commence immediately after applications for Stage 1 close on 31 May 2000 and will be completed by 30 June 2000. Planting of Stage 2 will commence immediately after applications for Stage 2 close on 29 September 2000 and will be completed by 31 December 2000.

**Proceeds**

41. The harvest proceeds will be paid to the Public Trustee and then distributed in the following order of priority:

- to pay harvesting and selling costs; then
- to pay any amounts owing to Forestry Tasmania under the Funding Agreement; then
- to the Growers.

**Finance**

42. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

43. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;

- additional benefits will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

44. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Grower for any purpose associated with the Project.

## Ruling

### Section 6-5: Assessable Income

45. Net sale proceeds derived from the timber produce harvested from the Project will be assessable income of the Growers, under section 6-5.

### Goods and Services Tax

46. 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

47. For a Grower who invests in the Project, the deduction available for the prepaid plantation establishment costs will depend upon the date that the investment is made and, in some cases, whether or not they are 'small business taxpayers'.

**IMPORTANT: Paragraph 48 (relating to 'small business taxpayers') and paragraphs 49 to 52 (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 53, 54 and 55 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.**

### **Growers who are small business taxpayers**

48. For a Grower who is a 'small business taxpayer' who invests in the project, the deductions shown in the table below will be available in the year in which they are incurred:

<b>Plantation establishment costs</b>	<b>Legislation ITAA 1997</b>	<b>Refer Note</b>	<b>Year 1</b>	<b>Year 2</b>
			<b>30/06/2000</b>	<b>30/06/2001</b>
Stage 1	8-1	(i)	\$3,000.00	
Stage 2	8-1	(ii)		\$3,000.00
<b>Total</b>			\$3,000.00	\$3,000.00

(Note: All figures shown are exclusive of GST)

- (i) Legislative change means that the full deduction will not be allowed in the year ended 30 June 2000 to Growers who are not 'small business taxpayers'. See paragraphs 49 to 51 and Example 1 at paragraph 94. Proposed legislative change applying to expenditure incurred after 1:00pm AEST 11 November 1999 means that for all Growers the full deduction may not be allowed in the year ended 30 June 2000.

See the non binding advice in paragraphs 54 and 55 and Example 2 at paragraph 95.

- (ii) Agreements in respect of Applications for Stage 2 will not be executed until on or after 1 July 2000.

### **Growers who are not small business taxpayers who invest on or before 30 June 2000**

49. 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 available in respect of the plantation establishment costs 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 94 illustrates the application of this method).

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50. In calculating the deduction available, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 whose '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:

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

$$B = (\text{Expenditure less A}) \times 80\%$$

**Year 2: Expenditure incurred after 30 June 2000 and on or before 30 June 2001**

Available deduction = A+B+C

Where:

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

$$B = (\text{Expenditure less A}) \times 60\%$$

C = Balance of the Year 1 expenditure not previously deducted

**Year 3: Expenditure incurred on or after 1 July 2001 and on or before 30 June 2002**

Available deduction = A+B+C

Where:

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

$$B = (\text{Expenditure less A}) \times 40\%$$

C = Balance of Year 2 expenditure not previously deducted.

**Growers who are not small business taxpayers who invest after 30 June 2000**

51. For a Grower who is not 'a small business taxpayer' and is carrying on a business, who invests in the Project after 30 June 2000, the deduction available in respect of plantation establishment costs will be as per the table shown at paragraph 48 for Year 2.

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

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

- section 82KL does not apply to deny the deductions otherwise allowable;
- expenditure by Growers who are small business taxpayers is not within the scope of section 82 KZM (but see paragraphs **54 and 55**);
- section 82KZMB applies to expenditure incurred by Growers in respect of fees of \$1,000 for services to be provided after 30 June 2000 and no later than 31 December 2000, who are not small business taxpayers and are carrying on a business (but also see paragraphs **54 and 55**);
- 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.

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**Proposed new laws**

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**Proposed changes to prepayment rules**

53. 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.

54. For these Growers, the amount of deduction available in respect of the Management Fee is calculated using the formula shown below (see also Example 2 at paragraph 95). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 of the ITAA 1997 whose '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.

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

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

#### **Note to promoters and advisers –**

55. **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**

### **Section 6-5: Assessable Income**

56. Net sale proceeds derived from the timber produce harvested from the Project will be assessable income of the Growers, under section 6-5.

### **Sections 27-5 and 27-30 – Goods and Services Tax**

57. Section 27-30 of the ITAA 1997 operates to deny a deduction that would otherwise be 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 on or after 1 July 2000.

58. 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 (on or 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**

59. In this Product Ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure.

60. Whether or not a Grower is a ‘small business taxpayer’ depends upon the individual circumstances of each Grower. It is the responsibility of each Grower to determine whether or not they are within the definition of a ‘small business taxpayer’.

61. 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.

62. ‘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).

**Section 8-1**

63. Consideration of whether plantation establishment costs are deductible under section 8-1, begins with paragraph 8-1(1)(a), 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 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a), and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income of the taxpayer.

64. 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 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.

65. Generally, an investor 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 timber;
- 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.

66. For this Project Growers have, under the Licence Agreement, rights in the form of Forestry Rights over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Services Agreement Growers appoint Forestry Tasmania to provide services. Growers are considered to control their investment.

67. The Licence Agreement and the Forestry Rights granted under it give Growers 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 licence term.

68. Growers have the right to use the land in question for afforestation purposes and to have Forestry Tasmania come onto the land to carry out its obligation under the Services Agreement. The Growers' degree of control over Forestry Tasmania, is sufficient. Under the Project, Growers are entitled to receive reports on the state of the tree crop and Forestry Tasmania's activities. Growers are able to terminate arrangements with Forestry Tasmania in certain instances, such as cases of default or neglect. The afforestation activities described in the Services Agreement are carried out on the Growers' behalf.

69. 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 Offer Document 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. The Independent Forester's assessment is that plantation yields will be economically viable.

70. Growers will engage the professional services of a body (i.e., Forestry Tasmania) 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.

71. 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.

72. 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, therefore, come within paragraph 8-1(1)(a). 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 section 8-1 are met. The exclusions do not apply.

### **Section 82KZM: Prepaid expenditure for small business taxpayers**

73. Section 82KZM of the ITAA 1936 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.

74. Under the Services Agreement, plantation establishment service fees of \$3,000 per hectare will be incurred when applications are accepted. For this Ruling's purpose, 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 no evidence that might suggest the services covered by the fee could not be provided within 13 months of the fee incurred.

75. Thus, for the purposes of this Ruling, it can be accepted that no part of the plantation establishment service fee of \$3,000 is for Forestry Tasmania 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 incurred by Growers, who are small business taxpayers’.

**82KZMA to 82KZMD: prepaid expenditure for taxpayers other than small business taxpayers**

76. 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.

77. 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 on or before 31 May 2000, transitional treatment applies to expenditure incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepaid expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to the Project.

78. The deduction available to Growers for the plantation establishment service fee will be determined in accordance with the rules contained in section 82KZMB.

79. 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).

80. Under Service Agreement, a plantation establishment fee of \$3,000 per hectare will be incurred on execution of that agreement.

81. Where the Grower invests prior to 1 June 2000, the Services Agreement provides that \$2,000 is payable in respect of services to be provided no later than 30 June 2000 (Pre July Services), and \$1,000 is payable in respect of services to be provided after 30 June 2000 and no later than 31 December 2000 (Post July Services).

82. With regard to Pre July Services, there is no evidence to suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this ruling it can be accepted that no part of the \$2,000 fee is for the Manager doing ‘things’ that are not to be wholly done within the year of income of the fee being incurred. The basic preconditions for the operation of sections 82KZMB and

82KZMC are not satisfied; therefore they will not apply to the expenditure by the Growers who are not small business taxpayers.

83. With regard to Post July Services, there is evidence to suggest the services covered by the fee could not be completed within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that the \$1,000 fee is for the Manager doing 'things' that are not to be wholly done within the year of income in which the fee is incurred. On this basis, the basic preconditions for the operation of sections 82KZMB and 82KZMC are satisfied. The provisions will apply to the plantation establishment fee of \$1,000 for a grower who is not a small business taxpayer and who invests in the project between 1 June 2000 and 30 June 2000.

84. Where the Grower invests after 30 June 2000 there is no evidence to suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling it can be accepted that no part of the fee is for the Manager doing 'things' that are not to be wholly done within the year of income the fee being incurred. The basic preconditions for the operation of sections 82KZMB and 82KZMC are not satisfied; therefore they will not apply to the expenditure by the Growers who are not small business taxpayers.

### **Proposed changes to prepayment rules**

85. 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. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

86. 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.

87. The arrangement relating to the Project and described at paragraphs 14 to 44 of this Product Ruling is within the description of a 'tax shelter arrangement'. Therefore, the plantation establishment fee incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided in the event that the proposed changes as described above are legislated. The formula for calculating the deductible amount is expected to be the same as that currently shown in subsection 82KZMD(2).

### **Section 82KL**

88. 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'.

89. '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.

90. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. There are no loans provided to the Grower by Forestry Tasmania or any related party. No 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

### **Part IVA**

91. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C), and a dominant purpose of entering into or carrying out the scheme to enable the relevant taxpayer to obtain a tax benefit in connection with the scheme (section 177D).

92. The Project will be a 'scheme' commencing when the Offer Document is issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of deduction for the plantation establishment costs 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 enabling the relevant taxpayer to obtain this tax benefit.

93. 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. The Independent Forester's Report states that the proposals contained in the Offer Document for the establishment of *Eucalyptus globulus* plantations are realistic, subject to the normal risks associated with afforestation operations, such as rainfall, climatic conditions and fire. There are no features of the Project, such as the payment of excessive management fees and non-recourse loan financing by any entity associated with the Project, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

## **Examples**

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

Joseph Gardener has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than \$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 in advance on 1 June each year for services to be provided for the following 12 months, 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.

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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:

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

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

$$B = (\text{Management fee less } A) \times 80\%$$

$$= (\$6,000 - \$493) \times 80\% = \$4,406$$

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:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 60\% = \$661$$

$$C = \$1,101$$

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 on or after 1 July 2001 and on or before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 40\% = \$441$$

$$C = \$440$$

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.

**95. Example 2: Obligation arising after 1pm AEST 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 (i.e., \$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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**Commissioner of Taxation**

17 May 2000

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<i>Previous draft:</i>	- ITAA 1936 82KZL (1)
Not previously issued in draft form	- ITAA 1936 82KH (1)
	- ITAA 1936 82KH(IF) (1)
	- ITAA 1936 82KZMA
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZMB
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 82KZM
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1936 82KZMC
PR 1999/95	- ITAA 1936 82KZMD
	- ITAA 1936 Pt IVA
<i>Subject references:</i>	- ITAA 1936 177A
- carrying on a business	- ITAA 1936 177C
- commencement of business	- ITAA 1936 177D
- fee expenses	- ITAA 1997 6-5
- interest expenses	- ITAA 1997 8-1
- management fees expenses	- ITAA 1997 27-5
- producing assessable income	- ITAA 1997 27-30
- product rulings	- ITAA 1997 Subdiv. 960-Q
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- schemes and shams	- ITAA 1997 960-340
- taxation administration	- ITAA 1997 960-345
- tax avoidance	- ITAA 1997 960-350
<i>Legislative references:</i>	
- ITAA 1936 82KL	

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## ATO references:

NO 2000/002862

BO

FOI number: I 102863

ISSN: 1441-1172