



# ***PR 2000/74 - Income tax: Heritage Paulownia Forests Project No 1***

 This cover sheet is provided for information only. It does not form part of *PR 2000/74 - Income tax: Heritage Paulownia Forests Project No 1*

 This document has changed over time. This is a consolidated version of the ruling which was published on *25 June 2001*



## Product Ruling

### Income tax: Heritage Paulownia Forests

### Project No. 1

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Previous Rulings	14
Arrangement	15
Ruling	39
Explanations	48
Detailed contents list	69

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.*

*[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.

## 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 Heritage Paulownia Forests Project No. 1, or simply as 'the Project' or the 'product'.

### Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- section 6-5 (of the *Income Tax Assessment Act 1997* (ITAA 1997));
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- Part 2-25 (ITAA 1997);
- section 82KL (of the *Income Tax Assessment Act 1936* (ITAA 1936));
- section 82KZM (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 82KZMC (ITAA 1936);
- section 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 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 laws 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, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

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

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 38) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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- the Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

### **Date of effect**

11. This Ruling applies prospectively from 21 June 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).

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

## **Withdrawal**

---

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. 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 change in the arrangement or in the persons' involvement in the arrangement.

## **Previous Rulings**

---

14. This Ruling replaces Product Ruling PR 2000/55, which is withdrawn on and from the date this Ruling is made (21 June 2000). Product Ruling 2000/55 will continue to apply to investors who entered into the Project on or before 21 June 2000.

## **Arrangement**

---

15. 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, 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:

- Application for a Product Ruling for the Heritage Paulownia Forests Project No. 1, dated 27 March 2000;
- Draft copy of Constitution for Heritage Paulownia Forests Project No. 1;
- Prospectus for Heritage Paulownia Forests Project No. 1 dated 4 May 2000;
- Draft copy of Management Agreement between Heritage Paulownia Forests Pty Ltd (the 'Manager'), Primary Securities Ltd (the 'Responsible Entity'),

Primary Securities Ltd (the 'Bare Trustee'), and the Grower;

- Draft copy of Sub-Management Agreement between Heritage Paulownia Forests Pty Ltd (the 'Manager') and Treefarm Projects Pty Ltd (the 'Forester')
- Draft copy of Head Lease Agreements between Rulings Pty Ltd (Lessor) and Treefarm Projects Pty Ltd (Lessee) for Lot 3692 and Lot 3689;
- Draft copy of Sub-Lease Agreement between Treefarm Projects Pty Ltd (Sub-lessor) and Primary Securities Ltd (Responsible Entity) and the Grower;
- Copy of Supplementary Prospectus dated 25 May 2000;
- Additional information provided by the applicant upon request.

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

16. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an investor, or any associate of the investor, will be a party to, except any finance agreements to which paragraphs 37 and 38 apply.

## Overview

17. This arrangement is called the Heritage Paulownia Forests Project No. 1.

Location	Near Gingin, approximately 70 kilometres north east of Perth in WA.
Type of business each participant is carrying on	Planting, cultivating paulownia trees for harvest, on designated Woodlot(s).
Number of hectares to be put under cultivation	up to 120 hectares
Number of trees per hectare	620
Size of the Woodlots	0.1 Hectare
Number of trees per Woodlot	62

**PR 2000/74**

Expected production	Expected to harvest after 8 years and recover 25 cubic meters of rough sawn timber per Woodlot.
The term of investment in years	8 years
Subscription amount per Woodlot	\$5,250
Minimum holding per Grower	2 Woodlots

18. The Project is to carry out a large scale planting of Paulownia trees. The trees will be harvested for their wood in the 8th year.

19. Growers entering into the Project will lease parcels of land (Woodlots) up to the 30<sup>th</sup> of December 2009. The minimum individual holding is two Woodlots, being an allotment of 0.2 hectares of land. The prospectus seeks subscriptions for a maximum of 1200 Woodlots. There is no minimum subscription.

20. Growers will enter into a contract with Heritage Paulownia Forests Pty Ltd (the Manager) to perform services in relation to the initial land preparation, acquisition and planting of seedlings, weed control, pest and fire control and management of their Woodlots. At the time the crop is ready for harvest the Manager will arrange for the harvest and milling, if applicable. The Manager will also arrange for the sale of the timber on behalf of Growers except for any Growers who elect to take possession of their timber and market it themselves. The Manager, on behalf of the Growers, will endeavour to sell the crop for the highest price available and as an incentive to maximise yields, the Manager will be entitled to fifty percent of the excess of the forecast Net Harvest Return as set out in the Prospectus.

21. A total of 1200 Woodlots are available for allotment. For Growers who are allotted Woodlots before 21 June 2000 ('Year 2000 Growers'), the initial services will be undertaken by the Manager prior to 30 June 2000 and the first annual management fee and rent payments are due on October 2000. For Growers who are allotted Woodlots after 21 June 2000 ('Year 2001 Growers') the initial services will not commence until after 30 June 2000, but will be completed before 30 June 2001, and the first annual management fee and rent payments are due on 1 October 2001.

22. The costs of participation for a Grower include the establishment fee of \$5,250 per Woodlot, annual management fees, annual rent, any financing costs that the Grower may incur, any insurance payments, and applicable GST. There will also be additional costs associated with the harvest and sale of the timber at the end of the Project.

**Lease Agreements**

23. Rulings Pty Ltd owns the land at Lot 3689 and has entered into a contract to purchase the land at Lot 3692, which will proceed if and when sufficient applications for subscriptions have been received. Both Lots are subject to Head Lease Agreements whereby they are leased to Treefarm Projects Pty Ltd, the Lessee. The Lessee must use the land for specified purposes which are compatible with the aims of the Project and is entitled to sublet Woodlots to Growers under the Scheme.

24. Treefarm Projects Pty Ltd will sub-lease Woodlots to individual Growers subject to Sub-Lease Agreements. The Woodlots are defined areas as specified by the Responsible Entity in the minute of Allotment pursuant to the Prospectus and identifiable on maps of the land. Under the terms of the Agreement, Growers covenant to pay the specified rent and undertake various duties pertaining to the establishment and cultivation of the trees and maintenance of the Woodlots. Growers are not permitted to use the Woodlots for any purpose other than the cultivation and harvesting of the trees and milling of the timber from those trees and may not permit various activities on the Woodlots which would be detrimental to the Project.

25. Growers are liable to pay annual rent on 1 October of each year, other than the first year, for 8 years. The rent payable for Year 2000 Growers for the period 1 July 2000 to 30 June 2001 is \$75 plus applicable GST, payable on 1 October 2000. In subsequent years an indexed amount is payable. The indexed rent is calculated by reference to the previous year's rent increased by 3% or the Consumer Price Index (the 'CPI'), whichever is greater. The CPI to be used is the aggregate percentage change in the CPI (All Groups, Perth) for the previous 4 quarters most recently published by the Australian Bureau of Statistics prior to the review date. For Year 2001 Growers, the first rent payment will be the indexed amount due on 1 October 2001.

26. Contemporaneously with the Sub-Lease, each Grower engages the Manager under the Management Agreement to supervise, carry out, manage and administer the performance of tree farming on the Grower's Woodlots on behalf of the Grower.

**Management Agreement**

27. Under the Management Agreement the Grower appoints Heritage Paulownia Forests Pty Ltd, the Manager, to carry out the duties required under the Sub-Lease Agreement, including to plant, manage, maintain and harvest the trees and mill the timber from the trees on the Woodlot.

28. In consideration of the performance by the Manager of its duties, the Grower will pay:



- an establishment fee of \$5,250 in the first year;
- annual management fees, starting at \$275 for Year 2000 Growers, and increasing in subsequent years;
- 'timber production costs', being the harvest fee and all transportation costs, drying costs and other associated costs necessary to prepare the Grower's timber for sale and the delivery of that timber to markets;
- a 'harvest and marketing fee' of 5% of the Gross Harvest Proceeds (the gross proceeds received from the sale of the timber);
- an 'incentive fee' of 50% of the amount by which the actual Net Harvest Return (i.e., the Gross Harvest Proceeds less the timber production costs and the harvest and marketing fee) exceeds the Net Harvest Return estimated in the Prospectus.

29. The annual management fee payable for Year 2000 Growers for the period 1 July 2000 to 30 June 2001 is \$275 plus applicable GST, payable on 1 October 2000. In subsequent years an indexed amount is payable. The indexed management fee is calculated by reference to the previous year's fee increased by 3% or the CPI, whichever is greater; or, a higher amount may be payable if in accordance with the provisions in the Agreement the Manager estimates that its costs of providing the services exceed this amount.

30. If agreed by both parties, the Manager will arrange insurance including fire insurance at the Grower's expense, in addition to public risk insurance.

31. The Manager will harvest the trees and advise Growers three months prior to the harvest of the expected dates and costs. The Manager will also sell the timber, for the highest price practicable, on behalf of the Growers except for Growers who lodge an election by notice in writing on or before 30 June 2002, that they wish to collect and sell their own timber.

32. The Manager will report to the Growers regularly on the operations on the plantation and other significant information.

33. The Manager will not provide any services until the execution of the Sub-Lease and Management Agreements. The Manager will defer execution of Agreements until after 30 June 2000 for investors who apply after 21 June 2000, as it will not be in a position to complete the necessary establishment services in less than the 9 days. Those applicants will become Year 2001 Growers. Furthermore, the Manager will defer execution of Agreements for investors over and above the number that it can manage to complete the establishment services for prior to 30 June 2000. For example, services for 800

Woodlots can be completed if 800 applications are received prior to 15 May 2000, 460 Woodlots can be completed if 460 applications are received prior to 6 June 2000, or 260 Woodlots can be completed if 260 applications are received prior to 15 June 2000.

### **Fees**

34. Under the terms of the Sub-Lease Agreement and Management Agreement, a Grower will make the following payments per Woodlot for the first 2 years of the Project:

<b>Expenses</b>	<b>Initial Year</b>	<b>Year 2</b>
Establishment Fee	5,250	-
Management Fee	-	275*
Rent	-	75*
<b>Totals</b>	5,250	350*

\* These amounts will be indexed for Year 2001 Growers

(Note: All figures shown are exclusive of GST)

35. There will be additional costs for Growers after the second year. These will consist of annual management fees, rent, any insurance premiums, and, in the final years, timber production costs, harvest and marketing fees and any incentive fees due. The Grower is also responsible for any applicable goods and services tax.

36. The establishment fees are payable on application. Annual fees due from the second year and onwards are payable on 1 October of the financial year to which the fees relate.

### **Finance**

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

38. This Ruling does not apply if a Grower enters into a finance agreement that includes 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 to Growers in 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.

## Ruling

---

### Goods and Services Tax

39. For a Grower who invests in the Project, section 27-5 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 a decreasing adjustment that a Grower has.

### Division 35 – deferral of losses from non-commercial business activities

#### Section 35-55 – Commissioner's discretion

39.1 For a Grower who is an individual and who entered the Project on or after 21 June 2000 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2008 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

39.2 Furthermore, for a Grower who is an individual and who entered the Project on or after 1 July 2000 and prior to any withdrawal of this Product Ruling, under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2009 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to

be carried on in a manner that is not materially different to the arrangement described in this Ruling.

39.3 This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies.

39.4 Where, either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

39.5 Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

### **Allowable deductions**

40. The following will be allowable deductions under section 8-1 of the ITAA 1997:

- rent paid by the Grower in relation to the Woodlots;
- management fees paid for the services outlined in the Management Agreement;
- establishment fees paid for the services outlined in the Management Agreement;
- insurance premiums to cover the Woodlots.

41. For a Grower who is a **Year 2000 Grower** the deductions shown in the Table below will be available for the years ended 30 June 2000 and 30 June 2001.

**PR 2000/74**

<b>Expenses</b>	<b>Legislation ITAA 1997</b>	<b>Year 1</b>	<b>Year 2</b>
		<b>30/6/2000</b>	<b>30/6/2001</b>
Establishment Fee	8-1	5,250	-
Management Fee	8-1	-	275
Rent	8-1	-	75
<b>Total</b>		5,250	350

(Note: All figures shown are exclusive of GST)

42. For a Grower who is a **Year 2001 Grower**, the establishment fee of \$5,250 will be payable and deductible in the year ended 30 June 2001. The first payments for management fees and rent for a Year 2001 Grower will be due in October 2001, and these amounts will be deductible in the same income year, i.e., the year ended 30 June 2002. The amount of management fee and rent payable will be calculated in accordance with the indexing provisions in the Management Agreement.

43. Any insurance premiums paid by the Grower in a year of income in respect of insurance cover for that year of income will be deductible in that year. Premiums which are prepaid to any extent may require apportionment over different periods subject to the relevant prepayment rules.

#### **Section 82KL, section 82KZM, sections 82KZMB – 82KZMD and Part IVA**

44. The expenditure for establishment fees does not fall within the scope of sections 82KZM, 82KZMB, 82KZMC, or 82KZMD as the services will be provided by the Manager wholly within the income year that the expenditure is incurred by the Grower:

- Where a Grower invests in the Project before 21 June 2000, the Grower will be a Year 2000 Grower and the services will be provided by 30 June 2000; and
- Where Growers invest in the Project on or after 21 June 2000, the Sub-Lease and Management Agreements will not be executed until after 30 June 2000, the Grower will be a Year 2001 Grower and the services will be provided entirely in the year they are paid for, i.e., the year ended 30 June 2001.

45. 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.

**Assessable Income**

46. For a Grower who invests in the Project, any gross proceeds received from the sale of produce from the trees from the Grower's Woodlot will be assessable income under section 6-5 of ITAA 1997 in the year of income in which the proceeds are derived.

47. Any produce on hand at the end of the income year will need to be accounted for in accordance with the trading stock provisions contained in Part 2-25 of ITAA 1997.

**Explanations****Sections 27-5: Goods and Services Tax**

48. Section 27-5 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 a Grower has.

**Section 8-1 ITAA 1997**

49. It is appropriate, as a starting point, to consider whether rent, establishment and management fees are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under the second limb if it is incurred when the business has not commenced; and
- where a taxpayer merely contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income.

**Is the Grower carrying on a business?**

50. 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 Project will constitute gross assessable income in their own right. The generation of business income from such a 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.

51. 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 produce;
- the Woodlot 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.

52. Under the Sub-Lease Agreement, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial grower. Under the Management Agreement, Growers appoint the Manager to provide services such as planting. The Agreement gives Growers full right, title and interest in the crop and the right to have it harvested and either sold for their benefit or they can elect to collect it and sell it themselves.

53. Under the Agreement, Growers appoint the Manager to provide services such as planting of trees and all operations necessary to develop, maintain and harvest the trees. The Manager is also responsible for selling the crop for non-electing Growers.

**An identifiable interest**

54. The Sub-Lease Agreement gives Growers an identifiable interest in specific trees and a legal interest in the leased land. Growers have the right to collect the crop harvested from their leased area or they may use the Manager to arrange the sale of their crop for them. Growers have a continuing interest in the trees from the time they are acquired until the end of the Project. There is a means to identify which trees the Growers have an interest in.

**Afforestation activities carried out by the Grower or on the Grower's behalf**

55. Under the Management Agreement Growers appoint the Manager to manage the Project. The Manager is to provide services including the cultivation, tending, fertilising, replanting, spraying and otherwise caring for the trees, and harvesting them.

56. Growers have an obligation to use the land in question for the cultivation of trees for the purpose of the Project. The activities described in the Management Agreement are carried out on the Growers' behalf. The Grower's degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Management Agreement, the Manager is required to prepare annual reports and send them to Growers no later than 31 January of each year starting from 31 January 2001 for Year 2000 Growers and 31 January 2002 for Year 2001 Growers. Growers are able to terminate their Agreement with the Manager in specified circumstances, such as a substantial breach by the Manager of a material obligation under the Agreement.

**General indicators of business**

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

58. The outgoings in question have the requisite connection with the operations that more directly gain or produce this income. That is, the fees directly relate to the planting, tending, maintaining and harvesting of the trees.

59. Growers have a continuing interest in the trees from the time they are acquired until the end of the Project. There is a means to identify in which trees the Growers have an interest. 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' activities will constitute the carrying on of a business.

60. The lease and management associated with the Woodlot activities relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income is to be gained from this business. They will be deductible under



paragraph 8-1(1)(a). The tests of deductibility under that paragraph are met. The exclusions in subsection 8-1(2) do not apply.

## **Expenditure of a capital nature**

61. Any part of the expenditure of a Grower entering into an afforestation business attributable to acquiring an asset or advantage of an enduring kind, is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, there are no capital components identified in the payments to be made by the Growers under the relevant Agreements.

## **Insurance**

62. Under the terms of the Management Agreement, if agreed by both parties, the Manager will arrange insurance including fire insurance for the Grower at the Grower's expense in relation to the Grower's Woodlots. Insurance premiums for fire, public risk or loss of profits are deductible. Therefore, if a Grower takes out insurance to cover any of these events, the premium will be deductible under section 8-1.

## **Assessability of income from the Project**

63. For a Grower who invests in the Project any income received by them from the sale of their trees, or from the sale of products from their trees, will be assessable income to them under section 6-5.

## **Section 82KL**

64. 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' and the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

65. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will arise to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

**Part IVA**

66. For Part IVA to apply there must be a ‘scheme’ (section 177A of the ITAA 1936); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

67. The Project will be a ‘scheme’. The Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of the tax deductions per leased area that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

68. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the produce from the trees. Further, there are no features of the Project, for example, such as the management fees being unusually high, not commercial and predominantly financed by a non-recourse loan, that might suggest that the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

**Detailed contents list**

69. Below is a detailed contents list for this Product Ruling:

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Class of persons	6
Qualifications	8
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Previous Rulings</b>	<b>14</b>
<b>Arrangement</b>	<b>15</b>
Overview	17
Lease Agreements	23
Management Agreement	27
Fees	34
Finance	37
<b>Ruling</b>	<b>39</b>

**PR 2000/74**

Goods and Services Tax	39
Allowable deductions	40
Section 82KL, section 82KZM, sections 82KZMB – 82KZMD and Part IVA	44
Assessable Income	46
<b>Explanations</b>	<b>48</b>
Sections 27-5: Goods and Services Tax	48
Section 8-1 ITAA 1997	49
Is the Grower carrying on a business?	50
An identifiable interest	54
Afforestation activities carried out by the Grower or on the Grower's behalf	55
General indicators of business	57
Expenditure of a capital nature	61
Insurance	62
Assessability of income from the Project	63
Section 82KL	64
Part IVA	66
<b>Detailed contents list</b>	<b>69</b>

**Commissioner of Taxation**

21 June 2000

*Previous draft:*

Not previously issued in draft form

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

*Related Rulings/Determinations:*

TR 92/1; TR 92/20; TR 97/11;  
 TR 97/16; TR 98/22; TD 93/34;  
 PR 1999/95

*Legislative references:**Subject references:*

- carrying on a business
- fee expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C

- ITAA 1936 177D
  - ITAA 1997 6-5
  - ITAA 1997 8-1
  - ITAA 1997 8-1(1)(a)
  - ITAA 1997 8-1(2)
  - ITAA 1997 27-5
  - ITAA 1997 Div 35
  - ITAA 1997 35-10
  - ITAA 1997 35-10(4)
  - ITAA 1997 35-30
  - ITAA 1997 35-35
  - ITAA 1997 35-40
  - ITAA 1997 35-45
  - ITAA 1997 35-55
  - ITAA 1997 35-55(1)
  - ITAA 1997 35-55(1)(b)
  - ITAA 1997 Pt 2-25
  - TAA 1953 Pt IVAAA
  - Copyright Act 1968
- 

## ATO references:

NO 2000/005310

BO

FOI number: I 1021498

ISSN: 1441-1172