


PR 2000/75 - Income tax: Queensland Pine Forest 2000 Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 June 2001*



Product Ruling

Income tax: Queensland Pine Forest 2000 Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **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

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.

The Australian Taxation Office (ATO) **does not** sanction or guarantee these products as investments. Further, we give no assurance that the products are 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 products. 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 arrangements are 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 arrangements will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangements have been implemented as described below and to ensure that participants in the arrangements 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 laws' identified below apply to the defined class of persons, who take part in the arrangements to which this Ruling relates. In this Ruling these arrangements are sometimes referred to as the Queensland Pine Forest 2000 Project, or just simply as 'the Project', the 'Product' or 'the Arrangement'.

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 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM (ITAA 1936);
 - section 82KZMC (ITAA 1936);
 - section 82KZMD (ITAA 1936);
 - Part IVA (ITAA 1936).
3. On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. On 11 November 1999 the Government announced further changes, some of which could also affect the tax laws dealt with in this ruling, especially those to do with 'tax shelters'. Some of those changes apply from the date of the announcement and others are proposed to apply from nominated dates in the future.
4. This Ruling does not deal with the Goods and Services Tax or any associated 'A New Tax System' legislative reforms, including the proposed changes announced as part of The New Business Tax System, except those legislative reforms which have now been enacted.

5. This Ruling does not deal with the announced changes which have not been enacted. We cannot rule on those changes until the relevant legislation is passed by Parliamentary process.

Class of persons

6. The class of persons to whom this Ruling applies is those who enter into either of the arrangements described below on or after the date this Ruling is made. They will have a purpose of staying in the relevant 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 arrangements 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. 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

10. 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).

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, this 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 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 arrangements during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangements or in the persons' involvement in the arrangements.

Arrangement

13. The arrangements that are the subject of this Ruling are described below. The relevant documents or parts of documents incorporated into this description of the arrangements are:

- Queensland Pine Forest 2000 Application for Product Ruling dated 6 April 2000, and annexures, including the following:
- Draft Prospectus prepared and issued by GRO Securities Ltd ('GROSL' 'Manager' or 'the Responsible Entity') for Queensland Pine Forest 2000 dated 5 April 2000;
- Queensland Pine Forest 2000 – Scheme Constitution incorporating Queensland Pine Forests Deed Poll dated 2 March 2000;
- **Forest Management Agreement between GROSL and GROSL as agent for the Grower;**

- Draft Forestry and Administration Services Agreement between GROSL and Greenfield Resource Options Pty Ltd (as the Plantation Manager) dated 11 April, 2000;
- Compliance Plan for Queensland Pine Forests Managed Investment Scheme adopted by GROSL dated 2 March, 2000;
- Custody Agreement between the Public Trustee of Queensland ('Custodian') and GROSL dated March, 2000;
- Lease between Hyne and Son Investments (Lessor) and The Public Trustee of Queensland (Lessee) (Unsigned and undated);
- **Draft Deed of Licence to Occupy to be executed by GROSL as agent for the Grower and the Custodian;**
- **Draft Off-take Agreement between GROSL as agent for the Growers and Hyne & Son Pty Ltd;**
- Constitution of GROSL adopted on 11 October 1999;
- Draft Plantation Unit Plan dated 6 March 2000;
- Supporting cash flow projections and claims provided with the application by the Responsible Entity;
- Letter from Johnston Rorke to the Australian Taxation Office dated 17 May 2000;
- Supplementary Prospectus for Queensland Pine Forests dated 31 July 2000;
- Public Rulings – Checklist Requests dated 22 December 2000;
- Letters received from GROSL dated 11 May 2001 and 15 May 2001.

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

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

Salient features of the arrangement

15. Participation in the Queensland Pine Forests 2000 project will enable investors to become a commercial grower through the licencing of Plantation Units upon which softwood forest plantations will be established at 'Coolalbin' for the purpose of selling and supplying timber, with the final harvest being in approximately year 24 of the project.

16. Applicants will appoint GRO Securities Limited (GROSL) to establish, maintain and harvest a pine plantation in accordance with the Forest Management Agreement. The Constitution sets out the terms and conditions under which GROSL agrees to act for the applicants (growers) and to manage the project.

17. The right of the grower to occupy the Plantation Unit is secured through the Head Lease between Hyne and Son and the custodian, the Public Trustee of Queensland. Each Grower will enter into a Licence to Occupy with the custodian. The Licence to Occupy will allow Growers access to Plantation Units for the purpose of conducting the afforestation business over the term of the project. Each Plantation Unit will be identified on a plantation map and growers will be given a copy of the plantation map, detailing the location of their Plantation Units.

18. On the completion of planting, each Plantation Unit will consist of a planted area of 2 hectares (4.8 acres) planted with approximately 2,222 Pine trees.

19. A maximum of 450 Plantation Units is available under this Prospectus. There is no minimum subscription and no Plantation Units will be offered after 30 September 2000.

20. Salient features of the arrangement are as follows:

Name used to describe the arrangement:	Queensland Pine Forest 2000 Project
Property location	property known as "Coolalbin" situated in Gin Gin, Queensland.
Type of Business Each Participant is Carrying on	Each grower will be commercially growing hybrid Pine Trees namely <i>Pinus eliottii</i> (slash pine) and <i>Pinus caribaea</i> (Caribbean pine), for harvest and sale to timber processors
Number of hectares under plantation:	maximum of 900 hectares (ha) (450 x 2ha plantation units)
Number of trees per hectare:	1100

Term of the plantation:	24 years
Fees for the period to 30 June 2001	\$4,411 (GST inclusive)
Initial fees on a per hectare basis:	\$2,205 (GST inclusive)
Ongoing yearly management and maintenance fees:	\$379.50 (GST inclusive) Y2 to Y5 Adjusted for CPI
Ongoing yearly Licence to Occupy Fee	\$359.70 (GST inclusive) Adjusted for CPI annually
Expected production:	refer to table below

Expected production

21. Expected production per plantation unit is as follows:

Year and operation	Projected volume	Products
Year 9 Thinning	144 m3	Pulpwood Round wood for treated posts
Year 17 Thinning	294 m3	Pulpwood Round wood for treated posts Sawlogs
Year 24 Final harvest	646 m3	Pulpwood Poles Sawlogs
Total	1084m3	

Total production on full plantation is forecast to be 488,000m3

Sales

22. On behalf of the growers, GROSL will sign an Off-take Agreement with Hyne and Son Pty Ltd. The Off-take Agreement provides that Hyne and Son Pty Ltd will purchase all pine trees at each thinning and final harvest from the Plantation Units. The market price for pine trees will be set at the time of each thinning and final harvest according to a market based formula outlined in the Off-take Agreement.

23. The purchaser is responsible for all harvest costs except harvest access roads. GROSL will deduct the harvest management fee and cost of access roads from the gross harvest proceeds before distribution to the growers. Net proceeds will be held in the relevant

proceeds fund by the Custodian for a maximum period of 90 days from the date of final payment from the purchase under the Off-take Agreement. At this time the Manager is required to provide a certified Statement to each grower reconciling the net proceeds paid to them.

Fees

24. Growers will receive a Licence to Occupy two (2) ha of land for a term of 24 years for each Plantation Unit acquired. An annual licence fee is payable.

25. After receiving the Licence to Occupy the relevant land Growers will enter into the Forestry Management Agreement to develop, establish and maintain the plantation over the period of the licence. Management Fees are payable under this agreement

26. Application fees payable under the Licence to Occupy, and Forestry Management Agreements per a 2 ha Plantation Unit are:

Year 1: licence fee and management fee

	Fee/ha	GST	Total
Licence Fee	327.00	32.70	359.70
Management Feet	3,683.00	368.30	4051.30
	4,010.00	401.00	4,411.00

Payment Options

Option A – Payable upon application	4,010.00	401.00	4,411.00
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Or

Option B – Deposit payable upon application	2,545.45	254.55	2,800.00
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Balance payable by 31 January 2001	1,464.55	146.45	1,611.00
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27. All application monies (\$4,411 per Plantation Unit) will be deposited into a trust account held by the Custodian known as 'Queensland Pine Forests – 2000 Project Application Account'. Once the business of afforestation commences, the Custodian will release funds to the Manager in accordance with the custody agreement. All services covered by the application money will be completed during the period 1 July 2000 to 30 June 2001. The project will not commence before 1 July 2000 and not commence after 30 September 2000.

Years 2-24: management fee (farm management agreement)

28. The Management Fee for year 2 is set at \$379.50 (GST inclusive) per Plantation Unit and may only be adjusted annually up to and including year 5 by any increase in CPI.

29. Thereafter the Management Fee is reviewed and fixed every five years. In the event of any increase in the Management Fee being greater than the increase in CPI for the corresponding period, such increase will be reviewed by the Independent Forester and the Independent Forester will report on the reasonableness of any increase.

Years 1-24: licence agreement (licence to occupy agreement)

30. Each Grower enters into a License to Occupy Agreement with the Custodian. The Licence to Occupy will allow growers access to their Plantation Unit for the purpose of conducting the business throughout the term of the project.

31. The licence is for 24 years from 1 July 2000 at a cost of 359.70 (GST inclusive) per 2 ha Plantation Unit, and will be subject to annual CPI adjustments.

32. The Grower shall not use the land jointly with anyone else and retains the right to say when the trees are to be planted. The land can only be subleased or disposed of with the Licensor's approval.

33. If the Grower defaults in the payment of fees, the Licensor can take possession of the land. If the Grower breaches any conditions, the Licensor may enter the land to remedy the breaches at cost to the Grower. Growers can elect to ensure their Plantation Units against loss from fire or windstorm. If the trees are destroyed and insurance proceeds obtained but not used for replanting, the Licence to Occupy may be cancelled and no further obligations exist. The premiums associated with this insurance are an additional cost of plantation ownership and are not covered by this Ruling.

Harvest management fee

34. A Harvest Management Fee of 5% of gross timber proceeds received from thinning and clear fell of trees from each Plantation Unit is charged by the Manager. The Manager shall deduct these fees from gross harvest proceeds prior to distribution to Growers.

Harvest access roads

35. It is estimated that the cost of harvest access roads (GST inclusive) will be:

Year	per 2 ha Parcel
	\$
9	299.20
17	518.10
24	700.70

The Manager shall deduct these fees from gross harvest proceeds prior to distribution to Growers.

Custodian fees

36. The Custodian is entitled to be paid 0.4% of net timber proceeds. The Manager shall deduct these fees from net gross harvest proceeds prior to distribution to Growers.

37. The duties of the custodian include:

- Holding the assets of the project;
- Maintaining bank accounts to hold application monies, rents and other income and issuing cheques;
- Entering into leases of the properties.

The constitution

38. The Constitution sets out the terms and conditions under which GROSL agrees to act for the Growers and to manage the project.

39. Within 30 days of lodgement of an application, GROSL is required to advise whether it has been accepted or rejected. Where the application is accepted, the Manager has two months to place the applicant ('Grower') on the register and provide the Grower with a copy of the Forest Management Scheme Agreement and Licence to Occupy.

40. At the conclusion of the Arrangement the Manager has 180 days to sell all of the assets and pass on the net proceeds, after covering costs, to the Growers. Anytime before the final harvest, Growers may transfer any of their interest in the project. Growers are bound by the Constitution by virtue of their acceptance into the project.

41. The Grower will complete a Power of Attorney to allow GROSL to enter into the agreements on the Grower's behalf and to execute and deliver the agreements. The Power of Attorney will last until 30 June 2000.

Forestry management agreement

42. A Forestry Management Agreement will be entered into between GROSL and each Grower. Growers contract with GROSL, as the Manager, to establish and maintain the Grower's Plantation Unit until maturity. The Manager shall use all reasonable endeavours to complete the following works in accordance with good forestry practices in respect of the leasehold property. GROSL may delegate its responsibilities.

43. Under the Farm Management Agreement GROSL will arrange for the following work to be performed.

Work to be done in Year 1 – by 30 June 2001.

GROSL shall arrange for the following work to be performed between 31 August 2000 and 30 June 2001:

- allocation;
- planning – development of management plan for establishment operations;
- preparation works;
- pre-planting weed control treatments as required;
- supplying and planting hybrid *Pinus elliotti*/*Pinus caribaea* seedlings at an average rate of 1100 per Hectare;
- application of fertiliser to seedlings;
- post planting weed control treatments as required;
- engage and fulfil Independent Forester's fees and expenses; and
- obtain public liability risk insurance of \$10,000,000.
- Report to Growers

Work to be done in year 2-(2001/2002):

- treatment of regrowth;
- weed and pest control treatments as required;
- folia analysis of planted stock;
- fire control operations as required;
- general maintenance.

Work to be done in Years 3 to 8 (2002/03 to 2007/08):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising, as required.

Work to be done in Year 9 – First Thinning (2008/09):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.
- development of access roads to enable removal of harvest material.
- arrange harvesting of timber and delivery to purchaser under Off-Take Agreement.
- scheduling of harvest operations.
- management of environmental compliance.
- arrange services of custodian and payment for same.

Work to be done in Year 10 to 16 (2009/10 to 2015/16):

- Fertilisation in Year 10
- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required;

Work to be done Year 17 – Second Thinning (2016/17):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.
- development of access roads to enable harvest.
- arrange harvesting of timber and delivery to purchaser under Off- Take Agreement.
- scheduling of harvest operations.
- management of environmental compliance.
- arrange services of custodian and payment for same.

Work to be done in Years 18-23 (2017/18) – (2022/23):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.

Work to be done in Year 24 – Final Harvest (2023/24):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.
- development of access roads to enable harvest.

- arrange harvesting of timber and delivery to purchaser under Off-Take Agreement.
- scheduling of harvest operations.
- management of environmental compliance.
- arrange services of custodian and payment for same.

Sundries:

- crop, fire and wind insurance is the responsibility of the Grower; and
- GROSL will arrange public risk insurance for period from commencement of the Project to the twenty-fourth year of the Project to the value of \$10,000,000.

Projected returns

44. The projected returns depend on a range of assumptions and GROSL does not give any assurance or guarantee whatsoever in respect of the future success or of financial returns associated with entering into the Licence to Occupy and Forestry Management Agreements being offered pursuant to the Prospectus. Based on the projections set out Section 4 of the Prospectus, an investor ('Grower') could expect to receive gross revenue of \$79,132 over the term of the arrangement. After harvest and other costs the expected profit per Plantation Unit over the term of the arrangement is \$46,855 which is an internal rate of return of 9%.

Finance

45. Growers may fund the cost of their plantation themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is involved in the provision of financing for the Project.

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

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project are or become involved in the provision of the finance;
- indemnity arrangements, or equivalent collateral arrangements limiting the borrower's risk;
- non-arm's length terms and conditions;

- additional benefits, for the purposes of section 82KL, are granted to borrowers, or the funding arrangement transforms the Project into a 'scheme' to which Part IVA may be applied;
- repayments of principal and payment of interest are linked to derivation of income from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Scheme, but are transferred (by any means, and directly, or indirectly), back to the lender, or any associate; or
- lenders do not have the capacity under the loan agreement, or do not have a genuine intention, to take legal action against defaulting borrowers.

Ruling

Section 8-1

47. Section 8-1 of the ITAA 1997 will apply to growers entering the Queensland Pine Forest Project 2000 to allow deductions as follows:

	Deduction per 2 ha for Year Ended 30 June		
	2001	2002	2003
Management and establishment fee	4051.30		
Annual management fee		379.50*	379.50*
Licence fee	359.70	359.70*	359.70*
TOTAL	4,411.00	739.20	739.20

* These amounts are subject to CPI adjustments.

Note:

- All amounts are GST inclusive
- Section 27-5 of the ITAA 1997 will apply to a Grower however, to reduce the amount of the deduction allowed by any input tax credit to which the Grower is entitled
- The initial management and establishment fee is incurred on execution of the Licence to Occupy and Forestry Management Agreement on or before 31 January 2001 for the financial year of income

ending 30 June 2001. Any payment received on or before 30 June 2000 will not be deductible in that year as no services will be performed before 30 June 2000 - the project is expected to commence on or after 1 July 2000.

- After the initial year, thereafter the annual management fee will be \$379.50* (GST inclusive) per annum, per 2ha Plantation Unit for work for work done between 1 July 2001 and 30 June 2002 and between 1 July 2002 and 30 June 2003 in relation to expenditure incurred on or before 30 June 2002 and 30 June 2003 respectively.
- A deduction will be allowable for the licence fee of \$359.70* (GST inclusive) per annum per 2ha Plantation Unit, incurred by a Grower in each of the financial years ending 30 June 2002 and 30 June 2003 respectively.

* These amounts are subject to CPI adjustments.

Assessability of income from the arrangement

48. For Growers who invest in the arrangement any income received by them from the sale of their timber will be assessable income to them under section 6-5 of the ITAA 1997.

Section 82KZM and section 82KL; Part IVA

49. For Growers who invest in the arrangement the following provisions of the ITAA 1936 have application as indicated:

- the expenditure incurred by growers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable under section 8-1 (ITAA 1997); 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

Losses from non-commercial business activities

50. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business

activity will not be allowed as deductions in the year that they arise. These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an individual with a loss from a primary production business activity where the taxpayer's non primary production assessable income for the income year (excluding any net capital gain) is less than \$40,000 (proposed subsection 35-10(4)).

51. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-45 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

52. The Project's agreements, its draft prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b). The discretion will be exercised for each of the income years commencing 1 July 2000 and ending 30 June 2003.

53. In accordance with the decision to exercise the discretion during this period, and subject only to the above condition relating to the Arrangement (discussed below at paragraphs 76 and 77), Growers can deduct losses arising from interests they hold in the Project in the years that such losses arise.

Explanations

Section 8-1

54. Consideration of whether Licence to Occupy and Forestry Management Fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;

- the outgoings are not deductible under the second limb (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 second limb applies. However, that does not preclude the application of the first limb (paragraph 8-1(1)(a) and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

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

56. 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 timber;
- the afforestation activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

57. For this arrangement growers have, under the Licence to Occupy and Forestry 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 to Occupy and Forestry Management Agreement growers appoint GROSL, as Responsible Entity, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. Growers are considered to have control of their investment. The specific cost to the Grower of these services provided during the period of provision of establishment services is \$4,411 (GST inclusive) which includes the first years licence fee. Growers have a guaranteed market for sale through the Off take agreement with Hyne and Son Pty Ltd.

58. The Licence to Occupy and Management Forestry Agreements gives Growers full right, title and interest in the Forest Produce and the right to have the Pine Trees sold for their benefit (clause 6 – Forestry Management Agreement). The relevant documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees situated on the 2 ha Plantation Units acquired by the Growers belong to the Growers. The Growers have an interest in the land on which they are growing through the Licence to Occupy. Growers are entitled to receive income from the sale of their produce, the price of which is determined by the pooling of their interests with other Growers.

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

60. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. The Independent Forester's report is that the arrangement is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the arrangement. This intention is related to projections contained in the Prospectus that suggest the arrangement should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

61. 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.

62. 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.

63. The fees associated with the afforestation activities will relate to the gaining of income from this business, and hence have a

sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

Section 82KZM

65. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

66. Under the Licence to Occupy and Forestry Management Agreements the fee of \$4,411 (GST inclusive) per Plantation Unit will be incurred on execution of those Agreement. These fees are charged for providing services to a Grower during the period from 1 July 2000 to 30 June 2001. As the arrangement will not commence before 1 July 2000, no services will be performed before 30 June 2000. Therefore no deduction is available in the financial year ending 30 June 2000. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

67. There is also no evidence that might 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, where the expenditure is incurred after 1 July 2000, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for GROS doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Grower. New sections 82KZMC and 82KZMD also have no application when an investment is made after 1 July 2000, since the services to be provided in respect of the initial fee are completed in the same year of income as the expenditure is incurred.

Section 82KL

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

Part IVA

69. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the Scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme' commencing generally on the date when the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the arrangement, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for the arrangement. 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.

70. Growers to whom this Ruling applies intend to stay in the arrangement for its full term and derive assessable income from the eventual harvesting of the trees. Further, there are no features of the Projects, for example, such as the Licence to Occupy and Forestry Management fee being 'excessive', and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient 'real money' coming into the Responsible Entity's hands, that might suggest the arrangement was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Proposed changes to losses from non-commercial business activities

71. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

72. In broad terms, the statutory tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

73. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in section 35-55(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

74. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2024 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

75. The discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for individual investors who acquire interests in the Project, the Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

76. The discretion in paragraph 35-55(1)(b) may be exercised where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

77. This Product Ruling is issued on a prospective basis (ie., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above in the manner described in the Arrangement, the Commissioner's discretion will not be exercised in respect of the

actual arrangement carried out as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

78. In deciding to exercise his discretion the Commissioner relies upon any and all information provided in respect of the Arrangement. Including:

- the report of the independent expert or scientific evidence provided with the application by the Responsible Entity;
- the binding off-take agreement between the Responsible Entity and Hyne and Son Pty Ltd for the sale of the timber setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the timber is grown; and
- supporting cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Detailed contents list

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Commissioner of Taxation

21 June 2000

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Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses

- interest expenses
- management fees expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KZM

PR 2000/75

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| - ITAA 1936 82KZMC | - ITAA 1997 6-5 |
| - ITAA 1936 82KZMD | - ITAA 1997 8-1 |
| - ITAA 1936 Pt IVA | - ITAA 1997 27-5 |
| - ITAA 1936 177A | - TAA 1953 Pt IVAAA |
| - ITAA 1936 177C | - Copyright Act 1968 |
| - ITAA 1936 177D | |
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