



PR 2000/95 - Income tax: APT Eucalypt Project 2001

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 November 2000*



Product Ruling

Income tax: APT Eucalypt Project 2001

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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 Ruling**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the APT Eucalypt Project 2001, or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - section 17-5 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM and sections 82KZMB - 82KZMD (ITAA 1936);
 - Part IVA (ITAA 1936);
 - Division 27 (ITAA 1997); and
 - Division 35 (ITAA 1997).

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered, for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. 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 Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. 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'.

8. 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

9. The Commissioner, rules on the precise arrangement identified in this 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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reproduction and rights should be addressed to the Manager,
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Date of effect

11. This Ruling applies prospectively from 30 August 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, 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 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.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2000/8, which is withdrawn on and from the date this Ruling is made. Product Ruling PR 2000/8 will continue to apply to investors who entered into the project on or before 30 August 2000.

Arrangement

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

- Correspondence dated 1 February 2000;
- The APT Eucalypt Project 2000 and APT Eucalypt Project 2001 Draft Prospectus, undated;
- APT Eucalypt Project 2001 Draft Supplementary Prospectus, undated;
- Constitutions for APT Eucalypt Project 2000 and APT Eucalypt Project 2001, dated 18 January 2000;
- **Lease and Management Agreement for the APT Eucalypt Project 2000 between APT Projects Ltd [the ‘Responsible Entity’], APT Land Pty Ltd [‘the Lessor’] and the Grower, undated;**
- **Management Agreement for the APT Eucalypt Project 2001 between APT Projects Ltd [the ‘Responsible Entity’], APT Land Pty Ltd [‘the Lessor’] and the Grower, undated;**
- **Proforma Lease for the APT Eucalypt Project 2001 between APT Projects Ltd [the ‘Responsible Entity’], APT Land Pty Ltd [‘the Lessor’] and the Grower, undated;**
- Compliance Plan for APT Projects Ltd as the Responsible Entity, regarding the Projects, undated; and
- Correspondence dated 17 July 2000 and 15 August 2000.

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

16. The documents highlighted are those the Growers enter into. 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, with the exception of finance agreements, to which paragraphs 38 to 40 apply. The effect of these agreements is summarised as follows.

Overview

17. These arrangements are called the APT Eucalypt Project 2001.

PR 2000/95

Location	South West Region of Western Australia or the Green Triangle region of South East South Australia and South West Victoria
Type of business each participant is carrying on	Commercial growing, and cultivation of <i>Eucalyptus globulus</i> trees (Tasmanian Blue Gums) for the purpose of producing timber for woodchipping and any other suitable product.
Number of hectares under cultivation	*5 000.
Name used to describe the product	APT Eucalypt Project 2001
Size of each Timberlot	1 hectare
Number of trees per hectare	1 000
Expected production	300 cubic metres / hectare
The term of the investment in years	11 approx.
Initial cost	\$5,898.20
Initial cost per hectare	\$5,898.20
Ongoing costs	Insurance to be provided by grower.

* The project may be expanded to increase the number of hectares under cultivation to up to 17 000 hectares.

18. Growers applying under the Draft Supplementary Prospectus enter into a Management Agreement and a Lease for the APT Eucalypt Project 2001. These Agreements are set out in the Schedule to the Constitution for the project. These Agreements give a Grower a lease from APT Land Pty Ltd, over an identifiable area of land called a 'Timberlot', until the Project is terminated pursuant to the provisions of the Constitution, or up until the trees are harvested and sold, and net income distributed, whichever happens first. Each Timberlot is one hectare in size.

19. The Project Land is situated in the South West Region of Western Australia or the Green Triangle region of South Australia and Victoria. APT Land Pty Ltd owns the property.

20. APT Land Pty Ltd will lease the Timberlot to the Grower to enable the Grower to carry on a long term commercial afforestation business. Growers are specifically granted rights to harvest timber on their Timberlot for this purpose.

21. The Prospectus states there is no minimum subscription for the Project. A Grower must apply for a minimum of two Project 2001 Timberlots under the terms of the Draft Supplementary Prospectus.

22. A minimum of 1,000 trees per Timberlot (1,000 trees per hectare) will be planted on or before 31 August 2001 for the APT Eucalypt Project 2001, following the execution of the Management Agreement and Lease for the 2001 Project (cl 6.2 and 6.4 of Constitution).

23. Possible projected returns for Growers are outlined on page 3 of the Draft Supplementary Prospectus. The projected returns depend on a range of assumptions and APT Projects Ltd does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Based on the example set out on page 1 of the Draft Supplementary Prospectus, a Grower could expect to achieve an after tax internal rate of return of 7.67% per Timberlot. Growers will execute a Power of Attorney enabling the Responsible Entity, APT Projects Ltd, to act on their behalf as required, when they make an application for a Timberlot.

Constitution

24. The Constitution for the project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity will keep a register of Growers (cl 20). Growers are entitled to assign their Grower's Interest in certain circumstances (cl 21). The Management Agreement is annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

Compliance plan

25. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in land

26. A lease is granted by the Responsible Entity to the Growers under the terms of the Lease for the APT Project Eucalypt 2001 (cl.2). Growers are granted an interest in land in the form of a lease to use their Timberlots for the purpose of conducting their afforestation business (cl 5). Growers must pay rent to the Lessor of an amount

equal to 10% of the Net Proceeds of Sale of their timber (cl 3). This fee will be paid by the Responsible Entity on behalf of the Grower out of the grower's Net Proceeds of Sale. The term of a Grower's lease is up to the date the trees on the Timberlots have been harvested and sold and the Responsible Entity pays the proceeds into the Proceeds Fund, which is expected to be approximately 11 years after commencement.

Management Agreement

27. Each Grower enters into a Management Agreement with the Responsible Entity for the APT Eucalypt Project 2001 for their Timberlots. The termination of the Project is the date the trees on the Timberlots have been harvested and sold and the Responsible Entity pays the proceeds into the Proceeds Fund (item 6 of schedule) which is expected to be approximately 11 years after the commencement of the Project. Accordingly, for the APT Eucalypt Project 2001, the harvest is expected to be in the year 2012. Growers contract with the Responsible Entity to establish and maintain the plantation until maturity. Growers pay a Plantation Preparation Services Fee and a Planting Services Fee for each Timberlot. The total fees payable under the Management Agreement for the APT Eucalypt Project 2001 is \$6,325 per Timberlot, payable in two instalments.

28. The Responsible Entity will supply and plant the *Eucalyptus globulus* seeds into planting pots, grow and care for seedlings, rip and mound the Timberlots, fumigate and poison for exterminating and controlling the Timberlots from rabbits, insects and other vermin, and spray for weed control, fertilise, cultivate, tend, maintain and otherwise care for the Timberlots as and when required according to good silvicultural and forestry practices.

29. The Responsible Entity will harvest (cl 17) and sell the timber produce on the Growers' behalf, at the maximum practicable price available (cl 19.1). The Grower may elect to take their own Collectable Forest Produce (cl.7). The Grower will be responsible for paying for the cost of annual insurance on the Timberlot (cl. 5.4).

30. The Responsible Entity may only be removed from its appointment in accordance with section 601FM of the Corporations Law.

Fees

31. The initial fee payable under the Management Agreement for the APT Eucalypt Project 2001 is \$5,898.20 per Timberlot. This fee comprises the Plantation Preparation Service Fee of \$5692.50 and \$205.70 for the Planting Service Fee for services to be performed by

30 June 2001 and is payable on application. The balance of the Planting Service Fee is \$426.80 and is payable on or before 1 July 2001 for services that will be performed between 1 July 2001 and 31 August 2001.

32. After harvest, Growers must pay the Responsible Entity a Harvest and Management Fee of 5% of their Net Harvest Proceeds and 10% of their Net Harvest Proceeds to the lessor for rental on their Timberlot over the life of the project. These amounts will be withheld by the Responsible Entity from the Grower's Net Harvest Proceeds before the harvest proceeds are paid out to the Growers.

33. The Independent Forester has stated, at page 33 of the Draft Prospectus, that the project should achieve its financial objectives if the forestry regimes set out in this report are followed, good marketing arrangements are put in place, and the international economy and climatic factors (especially rainfall) are favourable.

34. The Application Monies will be banked in the Application Bank Account formed under the Project's Constitutions (cl 5.1).

Planting

35. During the period 1 June 2001 to 31 August 2001 the Responsible Entity will be responsible for planting *Eucalyptus globulus* trees on the leased area. After 31 August 2001, the Responsible Entity will maintain the trees in accordance with good silvicultural practice. The services to be provided by the Responsible Entity over the term of the Project are outlined in the Management Agreement (items 10.11 and 12 of schedule).

36. The Responsible Entity will be responsible for arranging the marketing and sale of the timber produce. The Harvest shall take place when the forest produce equals or exceeds an average of 300m³/ha, or not later than 11 years after the commencement date, unless the Responsible Entity reasonably believes that it would be in the best interest of all Growers for the harvesting to be deferred to a later date.

37. The Proceeds of Sale of the Timber produce will be paid into the Proceeds Fund Bank Account. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to the Responsible Entity for a Grower's proportional share of the cost of felling and the cost of sale and to reimburse the Responsible Entity for Rental on the timberlot and the Harvest and Management fee; then
- to the Growers under the Management Agreement and the Constitution. (cl 32.1 of Constitutions).

Finance

38. Growers can fund their investment in the Projects themselves, borrow from an independent lender or borrow through finance arrangements offered by APT Finance Pty Ltd, an associate company of APT Projects Ltd.

39. 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;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers, for the purposes 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 payments of 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, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the project.

40. APT Finance Pty Ltd will offer Growers a loan to finance 100% of the Lease and Management Fees as applicable. The finance will be provided at a fixed interest rate and all principal and interest must be paid within 5 years of the first drawdown. The loan will be drawn down progressively as payments are required under the Management Agreement. The loans are made on a full recourse basis, and APT Finance Pty Ltd will pursue legal recovery action against defaulting borrowers.

Ruling

Section 8-1

Deductions where a Grower is not registered or not required to be registered for GST

41. A Grower may claim the deductions in the following table, where the Grower:

- participates in the Project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 31; and
- is not registered, or is not required to be registered for GST:

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002
Plantation Preparation Fee	8-1	\$5,692.50 See notes (i) and (ii) below.	
Planting Services Fee	8-1	\$205.70 See note (ii) below.	\$426.80 See note (ii) below.
Interest	8-1	See note (iii) below.	See note (iii) below.

Notes:

- (i) Where Management fees are prepaid, the fees are **NOT** fully deductible in the year incurred. The income tax deduction for each year's fees **MUST** be determined using the formula shown in paragraph 68.
- (ii) Management or lease fees of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. Deductibility of fees that exceed \$1,000, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as any prepaid Management fees, (i.e., using the formula shown in paragraph 68).

- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, Growers should read carefully the discussion of the prepayment rules in paragraphs 66 to 70 below as those rules may be applicable if interest is prepaid.

Deductions where a Grower is registered or required to be registered for GST

42. Where a Grower who is registered, or required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 31; and
- is entitled to an input tax credit for the fees;

then the deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of ITAA 1997). See Example 1 at paragraph 92.

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

43. For a Grower who participates in the Project and incurs expenditure in accordance with the Lease and Management Agreement, the following provisions of the ITAA 1936 have applications as indicated:

- (i) the expenditure by the Growers does not fall within the scope of section 82KZM;
- (ii) the expenditure by the Growers does not fall within the scope of sections 82KZMB-82KZMD;
- (iii) section 82 KL does not apply to deny the deductions otherwise allowable; and
- (iv) 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.

Prepaid fees

44. In this Project the Lease and Management Agreement that Growers enter into does not require fees to be paid by Growers prior to the commencement of each eligible service period. If, however, a Grower chooses to incur expenditure in respect of services to be

provided for a period that has not yet commenced then the prepayment will not be deductible in full in the year in which it is incurred.

Rather, using the formula shown below, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided (see paragraphs 66 to 70).

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

Section 35-55 – losses from non-commercial business activities

45. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001, 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 will decide for the income years ending 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

46. 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 (see paragraph 84 in the Explanations part of this ruling, below).

47. 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.

Section 6-5 - assessable income

48. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5 of ITAA 1997. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Explanations

Section 8-1

49. It is appropriate, as a starting point, to consider whether lease and management fees are deductible under paragraph 8-1(1)(a). This consideration 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 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.

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 timber's sale from the scheme, will constitute 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.

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

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

52. For this Project Growers have, under the Lease and Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Management Agreement, Growers appoint APT Projects Ltd, as Responsible Entity, to provide services such as supplying and planting seeds into planting pots, growing and caring for seedlings, ripping and mounding the Timberlot, fumigating and poisoning for exterminating and controlling the Timberlot from rabbits, insects and other vermin, spraying the Timberlot for control of weeds, and fertilising, spraying, cultivating, tending and otherwise caring for the trees as and when required according to good silvicultural and forestry practices. Growers are considered to control their investment. The specific cost of services provided by 30 June 2001 is \$5,898.20 per hectare (or Timberlot) with the balance of the services to be provided by 31 August 2001 at a cost of \$426.80.

53. The Management Agreement gives Growers the full right, title and interest in the products and the right to have the products sold for their benefit (clause 11.4) until the end of the lease term.

54. Growers have the right to use the land in question for afforestation purposes and to have the Responsible Entity come onto the land to carry out its obligation under the Lease and Management Agreement. The Growers' degree of control over the Responsible Entity, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on APT Project Ltd's activities. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as where the Responsible Entity has failed to perform any of its duties with due care and diligence. The afforestation activities described in the Management Agreements are carried out on the Growers' behalf.

55. 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 Draft Supplementary Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction. The Independent Forester's assessment was that plantation yields will be economically viable.

56. 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.

57. 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.

58. 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 the 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.

Sections 82KZM and 82KZMB - 82KZMD

59. 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 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.

60. Under the Management Agreement, fees of \$5,898.20 per Timberlot will be incurred on the execution of that Agreement. The fee is charged for providing services to a Grower by 30 June of the year of execution of the Agreement. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

61. There is also no evidence that might suggest the services covered by the fee could not be provided in 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 initial fee is for the Project Manager 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 incurred by the Grower.

62. New sections 82KZMB, 82KZMC and 82KZMD will also have no application to this Project provided the Grower incurs the fees as they fall due under the Lease and Management Agreement, 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

63. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, there may be a loan provided by APT Finance Pty Ltd to the Grower. The loan is provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

64. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme', commencing when the Prospectus is issued. The Growers will obtain an initial 'tax benefit' from entering into the scheme, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

65. 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 contained in the Prospectus states that the Project should achieve its financial objective if the forestry regimes set out in the report are followed, good marketing arrangements are put in place and the international economy and climatic factors (especially annual rainfall) are favourable. There are no features of the Project that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Prepaid fees

66. The amount and timing of deductions for any prepaid Management Fees or interest otherwise deductible under section 8-1 will depend on when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided.

67. Where a Grower participating in this Project incurs expenditure in respect of the doing of things (e.g., the performance of management services or the lending of money), prior to the commencement of the eligible service period, the prepaid expenditure

is not deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and whether the Grower is a 'small business taxpayer'.

68. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

69. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a small business taxpayer or section 82KZMD if the Grower is not a small business taxpayer. For small business taxpayers the amount and timing of the allowable deductions will then be calculated under the formula in subsection 82KZM(1) and for non-small business taxpayers under the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 68 above, concerning section 82KZMF.

70. Prepaid management fees of less than \$1,000 in each expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid management fees is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

(i) Growers who use APT Finance Pty Ltd as the finance provider

71. Some Growers may finance their participation in the Project through a loan facility with APT Finance Pty Ltd. Under the terms of the Loan Agreement to be entered into between those Growers and APT Finance Pty Ltd, all principal and interest must be paid within five years of the first drawdown.

72. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of growing the trees and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1, subject to the operation of sections 82KZME and 82KZMF.

73. The loan agreement under which the interest is incurred is directly related to all of the activities that are carried out under the Project, and so is a part of the 'agreement' (subsection 82KZME(4)). Consequently, where the interest is prepaid, it will satisfy the requirements of section 82KZME(1), and be subject to section 82KZMF, unless one of the exceptions applies. For a Grower acquiring a single interest in the Project any prepaid interest is expected to be less than \$1,000 and is therefore 'excluded expenditure' and Exception 3 (subsection 82KZME(7)) will apply. Therefore, the interest will be deductible in full in the year in which it is incurred.

74. However, where a Grower acquires more than one interest in the Project and the quantum of the interest is \$1,000 or more, the tax deduction each year must be determined using the formula in subsection 82KZMF(1).

(ii) Growers who DO NOT use APT Finance Pty Ltd as the finance provider

75. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than APT Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

76. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project, not described in the Arrangement or otherwise dealt with in the Product Ruling.

77. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in

subsection 82KZMF(1). The relevant formula is shown above in paragraph 68.

Small business taxpayers

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

79. 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.

80. '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).

Division 35 - losses from non-commercial business activities

81. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

82. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

83. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

84. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production

business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

85. In broad terms, the objective 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).

86. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2012. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

87. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

88. The first arm of 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 an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the 2001, 2002 and 2003 income years.

89. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner 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 will either pass one of

the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

90. This Product Ruling is issued on a prospective basis (i.e., 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 (see paragraph 45), in the manner described in the Arrangement (see paragraphs 15 to 40), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

91. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent forester and additional expert evidence provided with the application by the Responsible Entity.

Example

Example 1 – entitlement to 'input tax credit'

92. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a tax invoice which includes its ABN and shows the price of the taxable supply for management services (\$5,500).. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 *less* \$500).

Detailed contents list

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Commissioner of Taxation

 30 August 2000

Previous draft:

Not previously issued in draft form.

Related Rulings/Determinations:
 PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 98/22; TR 97/16;
 TD 93/34; IT 175; IT 2001
Subject references:

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax
- avoidance schemes
- tax shelters

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1936 82KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMB
- ITAA 1936 82KZMD
- ITAA 1936 Pt IVA
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- TAA 1953 Pt IVAAA
- Copyright Act 1968

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