



PR 2001/108 - Income tax: Great Southern Plantations 1996

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Product Ruling

Income tax: Great Southern Plantations 1996

Contents	Para
What this Product Ruling is about	1
Date of effect	12
Withdrawal	14
Arrangement	15
Ruling	37
Explanations	41
Detailed contents list	52

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Arrangement and Ruling parts of this document** are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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 this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Great Southern Plantations 1996', or just simply as 'the Project'.

Tax law(s)

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the 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 participating 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 these. 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 entered into the arrangement described below on or after 22 September 1994, the date of the first Prospectus applicable to this Project. They 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 have terminated or 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 the Ruling.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 36) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

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Date of effect

12. This Ruling applies prospectively from 27 June 2001, 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).

13. 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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who entered into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 26 March 2001;
- Prospectus No.2 for the Great Southern Blue Gum Project No. 2 issued on 22 September 1994;
- Prospectus No.3 for the Great Southern Blue Gum Project No. 2 issued on 8 November 1995;
- **Lease and Management Agreement** ('LMA') between Great Southern Managers Limited ('GSML'), the Trustee and the Grower;
- Trust Deed between GSML and the Trustee dated 21 January 1993;

- Supplemental Deed to the Trust Deed, dated 8 May 2000;
- **Loan Agreement** between Templegate Finance Pty Ltd ('TFPL') and the Borrower;
- Additional correspondence from the Applicant received 14 June 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.

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 a Grower, will be a party to, that are part of the arrangement to which this Ruling applies. The effect of the agreements listed above is summarised as follows.

Overview

17. The salient features of the arrangement are:

Location	The South West and "Great Southern" areas of Western Australia
Type of business each participant is carrying on	Commercial growing of <i>Eucalyptus globulus</i> for the production of short fibre hardwood woodchips for use in the paper industry.
Size of each Woodlot	0.36 hectares
Number of trees per hectare	Guaranteed minimum average of 1,000 per hectare 12 months after planting
Expected production	250 cubic metres per hectare
Term of the investment	Approximately 11 years
Initial cost	\$3,000
Initial cost per hectare	\$8,333
Ongoing costs	Lease and management fees payable from net harvest proceeds.
Other costs	Growers will bear harvest costs and the cost of all insurance except Public Liability Insurance.

18. The Project land is located in the South West and 'Great Southern' regions of Western Australia. Growers will have entered the Project through one of the two Prospectuses listed above issued for the Great Southern Blue Gum Project No.2. This Project has subsequently been registered as a Managed Investment Scheme

pursuant to the Corporations Law and renamed according to the year in which planting of the trees took place. This arrangement is now called Great Southern Plantations 1996.

19. Growers entering the Project will have entered into a Lease and Management Agreement with GSML as the 'Manager'. Upon registration as a Managed Investment Scheme, GSML has retired as Manager and Great Southern Managers Australia Ltd ('GSMAL') now manages the Project as the 'Responsible Entity'. The Agreement gives the Grower a lease over an identifiable area of land of 0.36 hectares called a 'Woodlot' until the final distribution of the sale proceeds is made to the Grower or until the Project is terminated. The Agreement also provides for *Eucalyptus globulus* seedlings (Tasmanian Blue Gum) to be planted on the Woodlots for the purpose of felling and sale in approximately eleven years.

20. Growers will have the right to apply to enter into a new Lease and Management Agreement with GSMAL to manage the coppice to produce a second crop from the original planting. This will be harvested when the volume of timber is appropriate.

21. Growers may have elected prior to 30 June 2000 to take their own Collectable Produce by giving written notice to the Responsible Entity and thereby become an 'Electing Grower' (clause 18.1) or the Responsible Entity will sell the forest produce on behalf of the 'Non-Electing Growers' for the maximum practicable price (clause 19.1).

Trust Deed and Constitution

22. The Project was originally established under a Trust Deed for the Great Southern Blue Gum Project. The Trustee acted as the representative of the Growers subject to the terms and conditions contained in the Deed. On 30 June 1999 the Trustee retired to enable the Project to be registered as a Managed Investment Scheme. The Manager subsequently nominated GSMAL to become the Responsible Entity for the Project.

23. A Supplemental Deed was executed by GSMAL on 8 May 2000. The Supplemental Deed replaced the Trust Deed and incorporates the Constitution for the Project. The Constitution establishes the Project and operates as a deed binding on all of the Growers of the relevant Project and the Responsible Entity. The Constitution sets out the terms and conditions under which GSMAL agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 26 of the Constitution, the Responsible Entity will keep a register of Growers. Growers may

assign their interest only in certain circumstances as set out in clause 7 of the Lease and Management Agreement.

Compliance plan

24. As required by the Corporations Law, a Compliance Plan has been prepared by GSMAL for the Project. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Deed and that the interests of Growers are protected.

Lease and Management Agreement

25. Growers participating in the Project are granted an interest in land by the Lessor in the form of a lease to use their Woodlot for the purpose of conducting their afforestation business. Each Grower must pay Rent to the Lessor in an amount specified in clause 3 of the Lease and Management Agreement. Payment of Rent is deferred until the year the harvest proceeds are received.

26. Some of the conditions of the lease are that the Grower:

- will not use, or permit to be used, the Woodlot for a purpose other than that of commercial silviculture;
- will not use, or permit to be used, the Woodlot for residential, recreational or tourist purposes;
- must pay annual insurance premiums;
- shall keep the Woodlot in good and substantial repair; and
- must not install upon or remove anything from the Woodlot.

27. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the Agreement. The services to be performed are specified in Item 10 of the Schedule to the Agreement. The Responsible Entity will supervise and manage all silvicultural activities on behalf of the Grower and must:

- supervise and manage all silvicultural activities to be carried on by the Grower;
- plant sufficient seedlings per Woodlot as would reasonably be expected to produce 250 cubic metres per hectare within eleven years from the Commencement Date;

- cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the trees;
- keep access roads in good repair and the Woodlot free from rabbits and other vermin; and
- maintain the Woodlot according to good silvicultural and forestry practices.

Fees

28. The fees payable under the Lease and Management Agreement on a per Woodlot basis are as follows:

- \$3,000 payable on Application for the first thirteen (13) months of the Term from the Commencement Date;
- At each relevant harvest, the Grower is required to pay an amount equal to 3.3% of the Net Proceeds of Sale of the harvest in consideration of the Responsible Entity meeting the ongoing management and maintenance expenses after the first thirteen months of the Term;
- At each relevant harvest, the Grower is required to pay an amount equal to 2.75% of the Net Proceeds of Sale of the harvest for Rent during the term of the Agreement.

29. The Responsible Entity will use its best endeavours to arrange insurance of the Leased Area on behalf of the Grower to cover against fire and other usual risks. The Grower is required to bear the cost of such insurance.

Planting

30. During the first thirteen month period of the Lease and Management Agreement, the Manager was responsible for planting *Eucalyptus* seedlings on the Woodlots. The Manager and Responsible Entity have maintained the trees according to good silvicultural practice and the Responsible Entity will continue to maintain the trees in accordance with good silvicultural practice. The services to be provided over the term of the Project are defined in Item 10 of the Schedule to the Agreement.

Harvesting and Sale

31. At all times the Grower has full right, title and interest in the Forest Produce and the right to have the forest produce sold for their

benefit (clause 11.3). Unless the Grower elects to take possession of their timber, the Responsible Entity will arrange the marketing and sale of the forest produce.

32. Harvesting is to take place when the forest produce equals or exceeds 250 cubic metres per hectare or no later than 11 years from the Commencement Date unless the Responsible Entity believes that it would be in the best interests of the Growers for harvesting to be deferred and the relevant Growers resolve to do so by ordinary resolution (clause 17 of the LMA).

33. Non-Electing Growers will share the Gross Proceeds of Sale on a proportionate basis following the payment of felling costs and costs of sale, and any amounts due and payable by the relevant Grower (clause 21).

34. If a Grower is an 'Electing Grower' (clauses 1 and 18 of the LMA), the Grower's proportional share of the costs of felling, rent owed to the Lessor and the Responsible Entity's remuneration, are due for payment at the time of collection specified by the Responsible Entity for collection of the Grower's Collectable Produce (clause 18.1 of the LMA).

Finance

35. Growers can fund their investment in the Project themselves, borrow from Great Southern Finance Pty Ltd (a lender associated with the Responsible Entity and formerly named Templegate Finance Pty Ltd) or borrow from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project, other than Great Southern Finance Pty Ltd (formerly named Templegate Finance Pty Ltd), are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;

- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

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

Section 35-55 - Commissioner's discretion

37. For a Grower who is an individual and who entered the 1996 Project, the rule in section 35-10 may apply to the business activity comprised by their involvement in the Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2006 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.

38. 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 44 in the Explanations part of this Ruling, below).

39. 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 the 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.

40. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in subsection 35-55(1) as an indication that the Tax Office sanctions or guarantees

the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

Explanations

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

41. 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.

42. 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.

43. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

44. 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 Projects, they are beyond the scope of this Product Ruling and are not considered further.

45. 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);

PR 2001/108

- (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).

46. A Grower who was accepted into and commenced participation in the 1996 Project is 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 Woodlot in the Project is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2007.

47. 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.

48. 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 years ended 30 June 2001 to 30 June 2006.

49. 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.

50. Information provided by the Applicant states that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the Arrangement in this Product Ruling.

51. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report of the Independent Forester and additional evidence provided with the application by the Responsible Entity;
- the financial projections contained in the Prospectus; and
- independent, objective and generally available information relating to the plantation timber industry.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	12
Withdrawal	14
Arrangement	15
Overview	17
Trust Deed and Constitution	22
Compliance plan	24
Lease and Management Agreement	25
Fees	28
Planting	30
Harvesting and Sale	31
Finance	35
Ruling	37
Division 35 - deferral of losses from non-commercial business activities	37
Section 35-55 - Commissioner's discretion	37
Explanations	41

PR 2001/108

Division 35 – deferral of losses from non-commercial business activities	41
Detailed contents list	52

Commissioner of Taxation

27 June 2001

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance

- tax benefits under tax avoidance schemes

- tax shelters
- tax shelters project

Legislative references:

- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)

ATO references:

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