



PR 2001/124 - Income tax: Tiwi Islands Acacia Project No. 1

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Product Ruling

Income tax: Tiwi Islands Acacia Project No. 1

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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**, **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 Tiwi Islands Acacia Project No 1, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Division 35 of the *Income Tax Assessment Act 1997* ('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 entered into the arrangement described in Product Ruling PR 1999/50 and as described below on or after 9 June 1999 and before 24 November 1999. They will have had 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 the Project.

Qualifications

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

10. If the arrangement described in this 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 the 9 June 1999, the date Product Ruling PR 1999/50 was made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the

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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 on or after 9 June 1999 and before 24 November 1999. 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 material difference 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 is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- **Draft Prospectus prepared in respect of 'the Project';**
- Draft Deed of Constitution dated 16 March 1999 establishing the Project;
- **Licence and Management Agreement between First Management Corporation ('FMC') and the Grower;**
- 'Agreement to Sub-Lease' between Australian Plantation Group Limited and FMC;
- 'Sublease consent' between the land owner and Australian Plantation Group;

- Indicative Term Sheet for Personal Loan Facility;
- Letter from applicant's tax professional adviser dated 9 April 1999;
- Facsimile copy of letter from applicant dated 29 April 1999 forwarded by applicant's tax professional adviser;
- Facsimiles from applicant's tax professional adviser dated 6 May 1999;
- Facsimiles from applicant's tax professional adviser dated 18 and 19 May 1999;
- Facsimiles from applicant's tax professional adviser dated 25 and 26 May 1999;
- Letter from applicant's tax professional adviser dated 8 December 2000; and
- Communication from applicant's tax professional adviser dated 26 June 2001.

Note: certain information received from the applicant regarding the Project has been provided with an understanding that it is on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

16. The documents highlighted in paragraph 15 in bold are those that may be entered into by the Grower. For the purposes of describing the arrangements to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which the Grower, or an associate of the Grower will be a party.

17. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

18. The arrangement is called Tiwi Islands Acacia Project No. 1.

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Location	Melville Island, one of the Tiwi Islands in the Northern Territory of Australia, 60 km north of Darwin.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Acacia mangium</i> trees for the purpose of producing woodchip or other suitable timber products.
Number of hectares under cultivation	2,000 hectares offered under this prospectus, with provisions for oversubscription.
Name used to describe the product	Tiwi Islands Acacia Project No. 1.
Size of the leased area	1 hectare
Number of trees per hectare	Approximately 1,111.
Expected production	300 m ³ /hectare
The term of the project	6.5 - 9.5 years
Initial cost per leased area	\$6,000
Initial cost on a per hectare basis	\$6,000
Ongoing costs per leased area	No annual costs. Final fee of 11% of Net Harvest Proceeds and 36.663% of amount that actual Net Harvest Proceeds exceeds that forecast in the Prospectus.

19. Growers were to be invited by way of prospectus to acquire an interest in the Project.

20. Growers who entered into the Project were to receive a licence ('Licence') of land from FMC on the Tiwi Islands in the Northern Territory, this land having been subleased to FMC by Australian Plantation Group Limited (APG) under the 'Agreement to Sub-Lease'.

21. The landowner was to lease the land to APG and was to consent to APG subleasing the land to FMC the responsible entity for the Project.

22. The Growers were to enter into a Licence and Management Agreement with FMC under which they were to be granted the Licence and were to have *Acacia Mangium* seedlings planted on their licensed land for eventual felling and sale, approximately 6.5 to 9.5 years after establishment.

23. There were 2,000 hectares of land on offer. The minimum area that may have been licensed by each Grower was 1 plantation

hectare. Approximately 1,111 trees per hectare were to be planted following the execution of the Licence and Management Agreement.

Licence and Management Agreement

24. Under the Licence and Management Agreement, Growers were to enter into a Licence for one or more hectares. Growers were to contract with FMC to establish and maintain the plantation until maturity and to harvest and sell the wood on their behalf.

25. The total afforestation activities were to be substantial and were to be undertaken in a businesslike manner on a regular basis for and on behalf of the Grower. The services provided by FMC included:

- the acquisition of *Acacia Mangium* seedlings on the Grower's behalf;
- cultivating, maintaining, fertilising, watering, spraying, pruning, thinning out and doing all other things necessary to the trees to produce mature trees;
- keeping down and exterminating upon the land all vermin and animal pests, insects and noxious plants and weeds, and complying with all laws and regulations with respect to the keeping down and exterminating of the same;
- arranging the insurances referred to in the Licence and Management Agreement including tree insurance at the Grower's option;
- employing such staff and labour as are necessary for the aforesaid purposes including, without limitation, engaging the services of such consulting experts as may be necessary to assist the Manager in providing expert advice and assistance with respect to the growing of the trees;
- providing adequate security for the land including, without limitation, constructing and maintaining security fences and fire breaks;
- provide adequate drainage to prevent and combat soil degradation;
- performing any of the duties of the Manager as required under the Licence and Management Agreement and the Constitution;
- land clearing; and

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- doing all other things that are necessary or incidental to the carrying out of the Growers' business to produce a viable business of growing of *Acacia Mangium* trees for woodchipping or other suitable purposes.

Fees

26. Under the Licence and Management Agreement, a fee of \$6,000 per hectare ('the **Fee**') was payable in advance in return for both the Licence for a period of 13 months from the Commencement Date ('the **Initial Term**') and for FMC purchasing the seedlings, land clearing, preparing the land for planting, planting the seedling trees and maintaining the Grower's lot for the Initial Term.

27. After the Initial Term, a further fee ('the **Final Fee**') was payable at maturity of the Project in consideration for the Licence and management services provided by FMC for the balance of the Licence and Management Agreement. That Final Fee will be the sum of an amount equal to 11% of the Net Harvest Proceeds and an amount equal to 36.663 % of the amount by which the actual Net Harvest Proceeds exceed the Net Harvest Proceeds projected in the Prospectus.

28. Other charges included tree insurance fees, which were available at the Grower's option.

29. FMC was to hold all of the Fees received by it from the Growers in bank deposits or government or semi-government securities and debentures and investments in short term money markets for the Initial Term, and was to draw on those funds as required to meet its obligations under the Licence and Management Agreement.

Land clearing

30. Land clearing expenditure of \$90 per hectare was to be incurred out of the \$6,000 per hectare Initial Fee. The land clearing expenditure comprised:

- \$51 per hectare for bulldozing and chaining to fell trees and other vegetative matter, and stump removal; and
- \$39 per hectare for burning the felled trees.

Planting

31. During the Initial Term, FMC was to be responsible for planting the *Acacia Mangium* trees. FMC is to maintain the trees in accordance with good silvicultural practice. FMC will be responsible for arranging the sale, hauling, loading and transporting of trees.

FMC is entitled to sell the trees on the stump rather than as cut logs. The harvest period is no earlier than 6.5 years and no later than 9.5 years after the Commencement Date.

32. FMC have engaged Sylvatech Australia Pty Limited and/or other consultants as required.

33. FMC will arrange for the sales of the trees prior to maturity and will use its best endeavours to obtain the maximum price available for the Grower. FMC will account to the Growers for the gross proceeds of the sale to which the Grower is entitled, after having deducted the Final Fees payable by the Grower in arrears.

Finance

34. Growers could choose to fund their investment themselves, borrow from an unassociated lending body or borrow through the funding arrangements organised by Laton Finance Pty Limited (**'Laton'**). Finance arrangements organised directly by the Grower with unassociated lending bodies are outside the arrangement to which this Ruling applies.

35. Laton, a company not associated with FMC, had arranged for loan facilities (**'a Loan'**) to be available from a number of independent financiers (each **'the Lender'**) to cover the fees payable to FMC.

36. The following Loan Establishment Fees were payable to Laton on the granting of the loan in the following amounts:

Loan Term	Loan Amount	Fees
12 month repayment plan	up to \$3,000	\$195
	over \$3,000	\$245
longer than 12 month repayment plan	up to \$10,000	\$390
	\$10,001-\$20,000	\$440
	over \$20,000	\$490

The Loan Establishment Fees were to be fully refundable if the Lender did not approve a Grower's Loan application.

37. This Ruling does not apply if a Grower entered into a finance agreement that included or had any of the following features:

- there were split loan features of a type referred to in Taxation Ruling TR 98/22;

- there were indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' were or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, were not available for the conduct of the Project but were 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 were involved or became involved, in the provision of finance to Growers for the Project.

Ruling

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

Section 35-55 - Commissioner's discretion

38. For a Grower who is an individual and who entered the Project on or after 9 June 1999 and before 24 November 1999 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2009 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

39. 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 45 in the Explanations part of this Ruling, below).

40. 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.

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

Explanations

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

42. 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.

43. 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.

44. 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.

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45. 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 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.

46. 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 is used on a continuing basis in carrying on the business activity in that year (section 35-45).

47. A Grower who was accepted into, and who has participated in the Project since 9 June 1999 is carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling and additional information provided since, 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 2010. Growers who acquired more than one interest in the Project may however, pass one of the tests in an earlier income year.

48. 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.

49. 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 acquired an interest(s) in the Project on or after 9 June 1999 and before 24 November 1999, the Commissioner has decided 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 2009.

50. 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.

51. 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.

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

- the report of the independent forestry expert and additional expert or scientific evidence provided by the Responsible Entity with the application and subsequently, in further information requested by the Commissioner; and
- the independent marketing report contained in the Prospectus which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Detailed contents list

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

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Commissioner of Taxation

11 July 2001

Previous draft:

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Related Rulings/Determinations:

PR 1999/95, PR 1999/50, TR 92/1;
 TR 97/16; TR 92/20; TR 98/22;
 TD 93/34

Subject references:

- carrying on a business
- commencement of a business
- management fees
- primary production
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits

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)
- ITAA 1936 82KL
- ITAA 1936 Pt IVA

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