



# ***PR 2001/127 - Income tax: Forestry Tasmania Trees Trust 1999***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *15 August 2001*



## Product Ruling

### Income tax: Forestry Tasmania Trees Trust 1999

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Contents	Para
<b>What this Product Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
<b>Ruling</b>	<b>35</b>
<b>Explanations</b>	<b>39</b>
<b>Detailed contents list</b>	<b>50</b>

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

#### ***Preamble***

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

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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**

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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

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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 Forestry Tasmania Trees Trust 1999, or just simply as 'the Project'.

### Tax law(s)

2. The tax law(s) that are 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 below between 2 June 1999 and 30 June 1999. 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. 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**

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11. This Ruling applies prospectively from 2 June 1999. 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 upon 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**

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who entered into the specified arrangement between 2 June 1999 and 30 June 1999. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## **Arrangement**

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14. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 1 March 1999;
- Amended Application for Product Ruling provided on 12 April 1999;
- Forestry Tasmania Trees Trust Offer Document 1999 provided on 12 April 1999;
- Final draft copy of **Management Agreement** between Forestry Tasmania and The Public Trustee of Tasmania ('the Trustee') for and on behalf of the Grower provided on 12 April 1999;
- Final draft copy of **Lease Agreement** between Forestry Tasmania and the Trustee for and on behalf of the Grower provided on 12 April 1999;
- Final draft copy of **Funding Agreement** between Forestry Tasmania and the Trustee provided on 12 April 1999;

- Final draft copy of **Swap Agreement** between Forestry Tasmania and the Trustee for and on behalf of the Grower provided on 12 April 1999;
- Trust Deed between Forestry Tasmania and the Trustee titled 'The Forestry Tasmania Trees Trust 1999' provided on 12 April 1999;
- Facsimiles from Forestry Tasmania dated 13 May 1999 and 19 May 1999; and
- Correspondence and attachments from Representative, dated 14 February 2001 and 14 June 2001.

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

15. The documents highlighted are those Growers enter into. For the purposes of this Ruling 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 party to. The effect of these agreements is summarised as follows.

16. Under the Offer Document, applications were invited from people wishing to participate in the Project. Those whose applications were accepted are referred to as 'Growers'. Growers had a choice of growing hardwood, with a maturity of 10 to 12 years, or softwood sawlog, with a maturity of 28 to 30 years. The application was for a minimum area of 1 hectare and applications were to be in multiples of 1 hectare. There was no minimum subscription. Where a Grower appointed Forestry Tasmania to provide plantation establishment services, the Grower's costs of entering the Project were \$3,000 per hectare. Where a Grower appoints Forestry Tasmania to provide management services during the period after plantation establishment and prior to harvest, the Grower shall pay Forestry Tasmania a fee of \$50 per annum.

17. Growers were granted interests in identified parcels of land. Growers also entered into a Management Agreement for the establishment and maintenance of the plantation.

18. The projected returns depend on a range of assumptions and Forestry Tasmania does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Scheme Agreements offered pursuant to the Offer Document.

## **Lease Agreement**

19. Under the Lease Agreement, Forestry Tasmania grants interests in land to the Growers, which are held by the Trustee for the benefit of the Growers. Growers are entitled to establish, maintain and harvest a crop of trees on the land in relation to which the interests in land are granted. In addition, the Growers have ancillary rights of access to, and of constructing and using facilities as may be necessary to establish, maintain and harvest that crop. The Growers also have a right to any provisions for charges, payments, royalties or division of the crop or the proceeds of the crop. Those rights are held by the Trustee on behalf of the Growers. The Growers have a right to call for registration of the interests in land and they remain the owners of the trees grown in their allocated parcels of land. The term of the Lease Agreement ends when the trees are harvested, or earlier if Forestry Tasmania acquires Grower's interests through the operation of the Scheme Agreements.

20. A grid showing 1 hectare squares superimposed over a plan of the area is to specifically identify the area of land allocated to each Grower. Appropriate records are to be maintained by Forestry Tasmania, who is to issue to the Trustee acting on behalf of Growers, a certificate for each parcel of land allocated to a Grower.

21. Forestry Tasmania also undertakes to provide services necessary to prepare the land prior to plantation establishment. For these services and for the provision of the interest in land and associated rights, it will receive a 50% share of the timber grown by the Grower on the land, together with the right to take and sell thinnings produced in the course of pre-establishment activities.

## **Management Agreement**

22. A Grower is responsible for planting its allocated area of plantation. Forestry Tasmania offers to provide to the Grower or procure that a third party provides to the Grower services to clear the land and establish the plantations for an all inclusive fee of \$3,000 per hectare, for both hardwood and softwood plantations, referred to as the Plantation Establishment Costs.

23. Under the Management Agreement, Forestry Tasmania is contracted to provide a range of forestry management services to Growers in three aspects. First, where the Growers retain Forestry Tasmania to provide plantation establishment services, Forestry Tasmania will provide such services at \$3,000 per hectare. Second, during the period after plantation establishment and prior to harvest, if it is retained to provide these services, Forestry Tasmania will provide general care and maintenance for the timber for a fee of \$50 per annum. In practice, as Forestry Tasmania agrees to pay ongoing

management costs as part of the consideration for its receipt of one half of the timber under the Lease Agreement, it (as landholder) will pay itself (as Forestry Manager) these fees. Thirdly, Growers may elect to have Forestry Tasmania harvest timber, on the terms set out in the Management Agreement.

24. Where Forestry Tasmania is not retained as a provider of management services, it will contribute the first \$50 per hectare per year for management services, but the Growers will be required to make up any difference between this and the actual expense.

### **Plantation Establishment Costs**

25. A Grower who appoints Forestry Tasmania to provide plantation establishment services will make only one payment to the Trustee, at the time of application to become a Grower. The Trust Deed provides for payment from the Trustee to Forestry Tasmania after planting has been completed.

26. Forestry Tasmania covenants that all plantation establishment services will be supplied within 13 months from the time the Grower is accepted into the Project. Any such services provided after this time will be provided at Forestry Tasmania's expense and the proportionate balance of the \$3,000 per hectare fee will be refunded to Growers.

### **Trust Deed**

27. The role of the Trustee as trustee of the Project is to facilitate the business of growing timber in forest plantations by Growers. It does not ultimately control the business of the Growers. Control is vested in the Growers through mechanisms provided in the Trust Deed and the Scheme Agreements.

28. The Trustee will:

- receive and disburse Growers' funds, where Growers elect to retain Forestry Tasmania to provide plantation establishment services;
- hold Growers' interests (in land and under various agreements);
- exercise Growers' rights under the various agreements, subject to directions given to the Trustee by the Growers;
- represent Growers in negotiations with Forestry Tasmania and other service providers; and

- where Growers elect to retain Forestry Tasmania to harvest timber, collect and distribute the proceeds of harvest.

29. The Trustee is obliged to provide regular reports to Growers and the Growers can remove the Trustee. One year after plantation establishment, Forestry Tasmania, in its capacity as the Manager, must give the Trustee a report regarding each planting area. The Trustee must then arrange for an independent forester to report on whether Forestry Tasmania has complied with its obligations under the Management Agreement. If Forestry Tasmania has failed to meet its obligations, it is required to conduct remedial works at its own expense.

30. The Trustee's fees including out of pocket expenses are \$150 per hectare of hardwood and \$200 per hectare of softwood. They, together with the costs of the independent forester, are deducted from gross harvest proceeds. The Trust Deed specifies that Growers are to receive half of the harvest proceeds net of trustee fees, money owed by the Growers to the Trustee and the costs of harvest.

31. The Trust Deed provides that Growers may only assign or transfer their interests in the Project to another person after 3 years after the date of entry into the Project.

## **Swap Agreement**

32. The returns from a single hectare of plantation forest timber are subject to high risk of loss of timber. Insurance is difficult to obtain and costly. Such a risk over an entire coupe (a growing area) is much less than in respect of a single hectare of plantation forest. Growers will agree with other Growers in their coupe that returns be averaged over the coupe. Forestry Tasmania will be party to these arrangements so that its one-half share of timber in each Grower's hectare would be increased or decreased accordingly. Similarly, in the case where not all land in a coupe has been allocated to Growers, and Forestry Tasmania grows trees on the unallocated land, Growers and Forestry Tasmania will agree to swap timber for a proportionate interest in all timber grown in that coupe.

## **Finance**

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

34. This Ruling does not apply if a Grower enters into a finance agreement with any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved in the provision of finance 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 applies;
- the loan is non-arm's length;
- repayments of 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**

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

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

35. For a Grower who is an individual and who entered the Project on or after 2 June 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 that the rule in section 35-10 does not apply to this business activity for the income years specified below:

- for a Grower who chose to grow hardwood, the income years ended 30 June 2001 to 30 June 2008; and
- for a Grower who chose to grow softwood sawlog, the income years ended 30 June 2001 to 30 June 2026,

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.

36. 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 42 in the Explanations part of this ruling, below).

37. 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.

38. 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**

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

39. 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.

40. 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.

41. 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.

42. 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.

43. 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).

44. A Grower who was accepted into, and who has participated in the Project since 2 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 chose to grow hardwood and/or softwood sawlog and acquires the minimum investment of one hectare in the Project is unlikely to pass one of the objective tests. Growers who acquired more than one hectare in the Project may, however, pass one of the tests.

45. Therefore, 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.

46. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has

# PR 2001/127

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 2 June 1999 and prior to any withdrawal of this Product Ruling, 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 period specified in paragraph 35 above.

47. 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.

48. 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.

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

- a letter dated 2 April 2001 and prepared by a forestry consultant that was provided by the Applicant; and
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the extract from the Offer Document provided by the Applicant.

## Detailed contents list

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

	Paragraph
<b>What this Product Ruling is about</b>	<b>1</b>
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
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
Lease Agreement	19
Management Agreement	22
Plantation Establishment Costs	25
Trust Deed	27
Swap Agreement	32
Finance	33
<b>Ruling</b>	<b>35</b>
Division 35 – deferral of losses from non-commercial business activities	35
Section 35-55 – Commissioner’s discretion	35
<b>Explanations</b>	<b>39</b>
Division 35 – deferral of losses from non-commercial business activities	39
<b>Detailed contents list</b>	<b>50</b>

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**Commissioner of Taxation**

 15 August 2001
 

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*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*PR 1999/95; 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
- viticultural expenses

*Legislative references:*

- ITAA 1936 Part IVA
- ITAA 1936 82KL
- 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)

Product Ruling

# PR 2001/127

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Page 14 of 14

FOI status: **may be released**

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ATO references:

NO T2001/007355

FOI number: I 1023009

ISSN: 1441 1172