



PR 2001/132 - Income tax: ITC Eucalypts 1999 Green Triangle Project

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Product Ruling

Income tax: ITC Eucalypts 1999 Green Triangle Project

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Preamble

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

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. 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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for participants 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, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

Participants 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.

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

Tax laws

2. The tax laws 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.

Changes in the Law

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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering 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 participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of Product Ruling PR 1999/2 and who entered into the arrangement specified below between 3 February 1999 and the withdrawal date of that Product Ruling. 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. 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 the Project.

Qualifications

9. The Commissioner rules on the precise arrangement identified 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. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 3 February 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 on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling

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has not commenced, 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

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 laws ruled upon, to all persons within the specified class who enter into the specified arrangement on or after 3 February 1999 during the term of Product Ruling PR 1999/2. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of PR 1999/2. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Prospectus dated 11 November 1998 in respect of ITC Eucalypts 1999 Green Triangle Project;
- **Lease and Management Agreement** between Integrated Tree Cropping Ltd ('ITC'), ITC Project Management Limited ('ITCPM') and the Grower;
- Constitution for ITC Eucalypts Scheme executed by ITC Project Management Limited, and dated 8 October 1998;
- Lease Deed ('Head Lease') between a Landlord, ITC and ITCPM;
- Contracting Agreement between ITC and ITCPM;
- Compliance Plan for ITC Eucalypts Scheme;
- ITC Tree Farm Term Loan Package including the **Tree Farm Loan Deed**;
- Letters from KPMG dated 8, 17, 18, 23 December 1998, 15 and 20 January 1999 and 2 March 2001, including amended **Lease and Management Agreement**.

NOTE: certain information in the letters from KPMG 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 that Growers entered into. 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.

16. This arrangement is called the ITC Eucalypts 1999 Green Triangle Project. Growers who entered the Project entered into a Lease and Management Agreement. Under this Agreement, Growers subleased land from ITC in Western Victoria and South Eastern South Australia, in an area known as the 'Green Triangle Region'. The sublease is for 12 years or the completion of harvesting. Under the Lease and Management Agreement the Grower also contracted with ITCPM to have Tasmanian Blue Gum trees (*Eucalyptus globulus*), planted on this leased land for the purpose of eventual felling and sale, approximately 10 years after establishment.

17. The Prospectus states that a minimum of 1,000 hectares is available for planting in 1999 and further land may be leased or planted in 1999 or prior to 31 July 2000. There is no overall minimum subscription but each investor must subscribe for a minimum 3 hectare plantation area. Possible projected returns for Growers are outlined on pages 6 and 7 of the Prospectus. The projected returns depend on a range of assumptions and ITCPM does not give any assurance or guarantee in respect of the future success of or financial returns associated with entering into Lease and Management Agreements being offered pursuant to the Prospectus. Rates of return will vary with the size of the investors' plantation areas.

Lease and Management Agreement

18. Growers entered into a 12 year lease with ITC for a minimum of 3 one hectare Leased Areas and contracted with ITCPM to establish and maintain a plantation on that land and harvest the timber produce on maturity. Clause 3 granted an interest in the land to the Grower and the trees remain the property of the Grower until the end of the term (cl 7(h)). Growers may elect to collect their own timber produce (cl 20), or ITCPM, acting as agent, will endeavour to sell the timber produce on the Grower's behalf (Item 1.3 of Schedule 2). Growers executed a power of attorney with their application enabling ITCPM to act on their behalf as required. The Agreement was conditional upon all necessary approvals from competent authorities being obtained within 6 months of execution of the Agreement or within such time as otherwise agreed (cl 2). Under the financial hardship provisions, Growers can apply after 5 years to have any amounts

owing under the agreement paid by ITCPM for the remainder of the Term in return for 5% of their sale proceeds for each year (or part year) the Manager makes payment on the Grower's behalf (cl 24).

Services and Fees

19. The Fees for Annual Services and Rent depend upon whether Growers were registered for GST or were required to be registered for GST.

20. The Initial Services Fee was comprised of a fixed charge of \$3,000 plus \$2,000 per hectare. This Fee covered plantation establishment activities as specified in the Agreement (Schedule 2, Item 1.1), including land preparation and the provision and planting of seedlings. This Fee was payable on the later of 30 June 1999 or the date of execution of the Agreement.

21. ITCPM held the application price in a special trust account. The application moneys will be released when ITCPM was satisfied that certain specified criteria have been met, as specified in the Constitution (clauses 7 and 8).

22. For Growers who are registered for GST :

- the initial year's Rent was \$200 per hectare payable on application,
- for the 2000 to 2004 years inclusive, except where it is the initial year, the Rent was/will be reviewed and varied using a formula based on CPI increases. It WAS/will be payable on 31 May each year,
- from the 2005 year onwards the Rent is the 1999 year Rent (for 1999 Growers) or the 2000 year Rent (for 2000 Growers) reviewed annually and varied using the formula based on CPI increases and then increased by 10% for the effect of GST. It will be payable on 31 May each year,
- the Fee for Annual Services for the 1999 to 2004 years inclusive was/is a fixed charge of \$200 plus \$75 per hectare, indexed for inflation after the first year. It was/will be payable on 31 May each year,
- for the 2005 year onwards the Fee for Annual Services is the 1999 year fee (for 1999 Growers) or the 2000 year fee (for 2000 Growers) reviewed annually and varied using the formula based on CPI increases and then increased by 10% for the effects of GST. It will be payable on 31 May each year.

23. For Growers who are not registered and do not need to be registered for GST:

- the initial year's Rent was \$200 per hectare payable on application,
- for the 2000 year, except where it is the initial year, the Rent was reviewed and varied using a formula based on CPI increases. It was payable on 31 May that year,
- for the 2001 year onwards the Rent was/is the 1999 year Rent (for 1999 Growers) or the 2000 year Rent (for 2000 Growers) reviewed annually and varied using the formula based on CPI increases and then increased by 10% for the effect of GST. It was/will be payable on 31 May each year,
- the Fee for Annual Services for the 1999 and 2000 years was a fixed charge of \$200 plus \$75 per hectare, indexed for inflation after the first year. It was payable on 31 May each year, and
- for the 2001 year onwards the Fee for Annual Services was/is the 1999 year fee (for 1999 Growers) or the 2000 year fee (for 2000 Growers) reviewed and varied using the formula based on CPI increases and then increased by 10% for the effects of GST. It was/will be payable on 31 May each year,

24. The Fee for Annual Services covered services specified in Schedule 2 (Item 1.2) of the Agreement. These services included infilling weed control, management of the crop, maintenance of fire control measures and equipment, inspection and preparation of reports. The manager also arranged for insurance against loss by fire, at the Growers' expense.

25. ITCPM will also arrange, manage and pay or arrange for payment of the costs of harvesting the Tree Crop and unless the Grower elects otherwise, arrange to market and sell the produce (Schedule 2, Item 1.3). The Fee payable for the Harvesting Services is 5.5% of the Harvest Proceeds (as calculated under Item 2.3 of Schedule 2) and is payable whether or not the Grower elects to market and sell the produce itself.

Planting

26. ITCPM was responsible for providing the Initial Services including planting *Eucalyptus globulus* on the Leased Area within 13 months of execution of the Lease and Management Agreement. ITCPM has and will continue to provide the Annual Services in

accordance with good silvicultural practice. ITCPM sub-contracted plantation establishment and maintenance functions to ITC under the Contracting Agreement made on 3 November 1998.

27. Growers will share on a proportionate basis in the Harvest Proceeds derived from the Leased Areas. There will be separate pools for Leased Areas established in the 1999 and 2000 years.

Finance

28. Growers could fund their investment in the Project themselves, borrow from ITC Finance Pty Ltd (a lender associated with the Responsible Entity) or borrow from an independent lender.

29. This Ruling does not apply if a Grower entered 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 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, 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 other than ITC Finance Pty Ltd, are involved or become involved, in the provision of finance to Members for the Project.

Ruling

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

Section 35-55 – Commissioner’s discretion

30. For a 1999 Grower who is an individual and who entered the Project on or after 3 February 1999 and prior to the withdrawal of Product Ruling PR 1999/2 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 2008 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.

31. For a 2000 Grower who is an individual and who entered the Project on or after 3 February 1999 and prior to the withdrawal of Product Ruling PR 1999/2 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.

32. 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 38 in the Explanations part of this ruling, below).

33. 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.

34. 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 commercially viable. 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

35. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual 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.

36. 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.

37. 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.’

38. 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.

39. 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) that 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).

40. A Grower who was accepted into and who has participated in the Project since 3 February 1999 is carrying on a business activity that is subject to these provisions.

41. Information provided with the application for this Product Ruling and additional information provided since, indicates that a 1999 Grower who acquires the minimum allocation of one interest in the Project is unlikely to have their business activity pass one of the objective tests until the income year ended 30 June 2009. For 2000 Growers, their business activity 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, find that their activity meets one of the tests in an earlier income year.

42. 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.

43. 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, 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;
- (ii) because of its nature, it has not satisfied one of the objective tests; and
- (iii) 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.

44. A 1999 Grower who acquires the minimum allocation of one interest in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2009. The Commissioner has decided for such a Grower that it would be reasonable to exercise the

second arm of the discretion until the year ended 30 June 2008. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2008.

45. A 2000 Grower who acquires the minimum allocation of one interest in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2010. The Commissioner has decided for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2009. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2009.

46. 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. If, however, the Project is not carried on during the income years specified above (see paragraph 30 and 31), in the manner described in the Arrangement (see paragraphs 14 to 29), this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

- the report of the independent expert and scientific evidence provided by the Responsible Entity with the application and subsequently, in further information requested by the Commissioner;
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projection and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Detailed contents list

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

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Commissioner of Taxation
17 October 2001

Previous draft:

Not previously issued in draft form

- schemes
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- tax benefits
- viticultural expenses

*Related Rulings/Determinations:*PR 1999/95; TR 92/1; TR 97/16;
TR 92/20; TR 98/22; TD 93/34*Legislative references:**Subject references:*

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

- 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

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- 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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