



PR 2001/14 - Income tax: ITC Sandalwood Project 2001

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Product Ruling

Income tax: ITC Sandalwood Project 2001

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications sections**), **Date of effect**, **Withdrawal**, **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 as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

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

What this Product Ruling is about

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

Tax laws

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 (ITAA 1997);
 - section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZL (ITAA 1936);
 - section 82KZM (ITAA 1936);
 - sections 82KZMB - 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to 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 who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to Promoters and Advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date of this 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 as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

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

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 49) 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

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- the Ruling will be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 14 February 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 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

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 9 October 2000;

- Draft Prospectus issued by ITC Project Management Ltd ('ITCPM'), received 11 January 2001;
- Draft **Management Agreement** between ITCPM and the Grower, undated, received 5 February 2001;
- Draft **Lease Agreement** between ITCPM and the Grower, undated, received 5 February 2001;
- Draft **Forest Right** between ITCPM and the Grower, undated, received 5 February 2001;
- Draft Constitution of the ITC Sandalwood Project 2001, undated, received 5 February 2001;
- Compliance Plan for the ITC Sandalwood Project 2001, dated 31 May 2000;
- Additional correspondence from the Applicant dated 11 January 2001 and 2 February 2001.

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

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, 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, which are a part of the arrangement. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called the ITC Sandalwood Project 2001.

Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of Indian Sandalwood trees (<i>Santalum album</i>) for the purpose of harvesting and selling timber.
Number of hectares to be under cultivation	80
Size of each leasehold area	0.1 hectares
Minimum investment	0.4 hectares
Number of Sandalwood trees per hectare	440
Expected production	11,880kg per hectare
The term of the investment	15 years

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Initial minimum cost	\$11,000
Initial minimum cost per hectare	\$27,500
Ongoing costs	Lease and Management Fees (may also be prepaid).

18. The Project will be situated on 80 hectares of land near the Ord River in Kununurra, Western Australia described as:

- Portion of King Location 276 being part of the land contained in Certificate of Title Volume 1637 Folio 385.

19. There is no minimum subscription for the Project. The Project may be extended within Western Australia or Queensland if additional subscriptions are received and irrigated land can be identified that is deemed suitable by the Independent Forester. Growers participating in the arrangement on land in Western Australia will enter into a Lease between ITCPM, as the Responsible Entity, and the Grower. Growers participating in the arrangement on land in Queensland will enter into a Forest Right between ITCPM and the Grower on the same terms. Where this Ruling uses the term 'Lease' it is intended to also include the term 'Forest Right' in the same context.

20. The Lease is over an identifiable area of land called a 'Plantation Unit' until the trees are harvested and sold and the net income distributed. Each Plantation Unit is 0.1 hectares and will be planted with Sandalwood seedlings plus host plants and trees. Each investor is required to subscribe for a minimum of four Plantation Units. These Plantation Units are separately identified on a Plantation Area Map annexed to the agreement. Growers will receive a Certificate detailing the Plantation Units they have been allocated.

21. For Growers that enter the Project by 31 May 2001, ITCPM undertakes to ensure that Primary Services are completed by 30 June 2001. From 1 June 2001, ITCPM will not accept applications for any Plantation Units where it is apparent that they will not be able to complete all of the Primary Services by 30 June 2001. ITCPM will be monitoring on a daily basis its ability to complete the Primary Services by 30 June 2001. Applications processed on or after 1 July 2001 and prior to the closing date of the Prospectus will commence participation in the Project in the 2001/2002 income year.

22. The Growers will also enter into a contract with ITCPM for the management of their Plantation Area. ITCPM will be responsible for establishing and cultivating the trees and harvesting, processing and selling the timber. The trees are expected to be harvested in the year 2016. Growers may elect, within 12 months of the Commencement Date, to market and arrange for the sale of their Tree Crop by giving written notice to ITCPM and thereby become a Selling Grower (clause

9.1(a) of the Management Agreement) or ITCPM will arrange the sale of the Tree Crop on behalf of the Non-Selling Growers.

23. Growers will execute a Power of Attorney enabling ITCPM to act on their behalf as required, when they make an application for four or more Plantation Units.

Constitution

24. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which ITCPM 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. Growers may assign their interest in certain circumstances as set out in clause 10 of the Management Agreement. The Responsible Entity:

- prepares the Management Agreement and lease documents (clause 6);
- ensures that Application Moneys are not released until the appropriate agreements are in place (clause 8);
- keeps a register of Growers (clause 27); and
- distributes profits (clause 30).

Compliance Plan

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

Interest in Land

26. Growers participating in the Project are granted an interest in land by ITCPM in the form of a sub-lease or right to use their Plantation Area for the purpose of conducting their afforestation business. A sub-lease will be granted through a Lease agreement to Growers whose Plantation Area is located in Western Australia. A forest right will be granted through a Forest Right agreement to Growers whose Plantation Area is located in Queensland. The Lease or Forest Right is granted in accordance with the provisions set out in the agreement (clause 2). Growers may assign their interest in certain circumstances (clause 13).

27. Some of the conditions of the lease are that the Grower:
- will not use the Plantation Units for a purpose other than growing and harvesting trees;
 - comply with sound silvicultural and environment practices adopted within the forestry industry; and
 - comply with all laws and regulations relating to the use and occupancy of the Grower's Plantation Units.

Management Agreement

28. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultant and other specialist services as may be reasonably necessary. The services which ITCPM must perform are specified in Schedule 2 and include:

- procure sufficient seedlings to the recommended specifications;
- plant the seedlings and maintain adequate stocking of the plantation in accordance with the Management Plan by replacing any contiguous area of dead or missing Sandalwood trees and their hosts;
- maintain access roads and use all reasonable measures to keep the Plantation Area free from vermin; and
- control weeds, prune and irrigate the Tree Crop and report on the growth of the trees every six months.

Fees

Management Fees

29. Management Fees are payable to ITCPM by the Grower for each Plantation Unit. The following amounts are payable under the Management Agreement:

- Primary Services fee of \$2,200 plus \$2,200 for each Plantation Unit payable to ITCPM on Application;
- Planting Services fee of \$220 for each Plantation Unit payable on execution of the Agreement or 30 November 2001, whichever is the later.

30. There are two options for the payment of management fees after the initial period. These are:

Option 1 - Annual Management Fees

31. The following amounts are payable in accordance with Item 3 of Schedule 3:

- Annual Services fee of \$220 plus \$110 per Plantation Unit payable on execution of the Agreement or 30 November 2001, whichever is the later;
- Thereafter, the Annual Services fee will be indexed in each subsequent year at the annual rate of inflation, payable on 30 November of each year;

Option 2 - Prepayment of Annual Services Fees

32. Growers may elect to prepay fees for Annual Services for a period of 15 years. This amount is payable on or before the Commencement Date and is the total of:

- \$3,300; and
- \$1,650 for each Plantation Unit.

33. If the final harvest of the Plantation Area occurs after 30 June 2016, Growers will be required to pay an additional fee in accordance with Item 3 of Schedule 3 to the Management Agreement from 1 July 2016 to the date of harvest.

34. If the final harvest of the Plantation Area occurs before 30 June 2016, ITCPM will refund to the Grower \$220 plus \$110 per Plantation Unit for each whole year between the date of final harvest and 30 June 2016.

Lease Fees

35. Commencing from 1 July 2001 each Grower must also pay an annual fee to ITCPM in an amount specified in Schedule 2 of the Lease agreement. There are two options for payment. These are:

Option 1 - Annual Lease Fees

36. Growers may pay an annual fee for each year of the Project as follows:

- \$110 per Plantation Unit for the period 1 July 2001 to 30 June 2002 payable on 30 November 2001;

- for each subsequent financial year the fee will be set at the amount of the fee in the prior year indexed at the annual rate of inflation, payable on 30 November of each year.

Option 2 - Prepayment of Lease Fees

37. Growers may elect to prepay the fees for a period of 15 years. The total for this payment is \$1,650 per Plantation Unit payable on or before the Commencement Date.

38. If the final harvest of the Plantation Area occurs after 30 June 2016, Growers will be required to pay an additional fee in accordance with Items 1 and 2 of Schedule 2 to the Lease agreement from 1 July 2016 to the date of harvest.

39. If the final harvest of the Plantation Area occurs before 30 June 2016, ITCPM will refund to the Grower \$110 per Plantation Unit for each whole year between the date of final harvest and 30 June 2016.

40. ITCPM is also entitled to the following amounts that will be deducted from the Harvest Proceeds:

- the Grower's proportional share of the costs of harvesting; and
- a Harvesting and Marketing Fee equal to 10% of the Harvest Proceeds.

41. The Draft Prospectus states at page 19 that ITCPM will insure the Plantations against fire and windstorm at its cost until 30 September in the year of planting. Thereafter, ITCPM will arrange insurance of the Plantation Area on behalf of the Grower to cover against fire and windstorm if so requested. Any insurance premium will be payable by the Grower and ITCPM will charge a fee equal to 10% of the premium paid by the Grower to arrange the insurance.

42. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Application Fund in the name of the Responsible Entity. The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 8 and 9 of the Constitution).

Planting

43. During the period from the Commencement Date until 30 June 2002, ITCPM will be responsible for planting Sandalwood

seedlings on the Plantation Area at a rate of 440 per hectare. ITCPM will also plant other seedlings or trees as may reasonably be necessary or required to encourage the growth of or protect the Sandalwood seedlings or trees. After planting ITCPM will maintain the trees in accordance with good silvicultural practice. The Plantation Area will be replanted to maintain adequate stocking of the Plantation in accordance with the Management Plan by replacing any contiguous area of greater than 10 dead or missing Sandalwood trees or 10 dead or missing host trees. The services to be provided by ITCPM over the term of the Project are outlined in Schedule 2 of the Management Agreement.

Harvesting

44. The Grower may, within 12 months of the execution of their agreement, elect itself to market and arrange for the sale of the Tree Crop (clause 9.1) or ITCPM will use reasonable endeavours to sell the Tree Crop on the Grower's behalf (Item 4(d) of Schedule 2).

45. Harvesting is expected to take place approximately 15 years after the establishment of the Plantation but is at the discretion of ITCPM. ITCPM will be entitled to 10% of the Harvest Proceeds as a fee payable for Harvesting and Marketing Services.

46. The proceeds from the sale of timber of Non-Selling Growers will be paid direct to ITCPM who must deposit them into a Proceeds Fund (clause 3.3(c) of the Constitution). All Growers must pay the reasonable costs incurred by ITCPM in relation to the carrying out of the Harvesting and Marketing Services. Each Grower will have a share in the Proceeds Fund which will be distributed among the Non-Selling Growers according to their Proportional Interest. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1 of the Constitution.

47. If a Grower is a 'Selling Grower' (clauses 1 and 9 of the Management Agreement), ITCPM will deliver the Grower's proportional share of the forest produce to an address nominated by the Grower. Prior to delivery the Grower must pay to ITCPM the costs of harvesting and delivery of the forest produce and any rent or fees owing to ITCPM (clause 9.1(c) of the Management Agreement).

Finance

48. Growers can 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.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' 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 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;
- 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 for the Project.

Ruling

Section 6-5 - Assessable income

50. Gross sale proceeds derived from the sale of timber harvested from the Project, less any GST payable on these proceeds, will be assessable income of the Growers under section 6-5 of the ITAA 1997. Section 17-5 of the ITAA 1997 excludes amounts relating to GST payable on taxable supplies from assessable income.

Section 8-1

Deductions where Growers are not registered nor required to be registered for GST

2001 Growers

51. A Grower may claim the deductions in one of the following tables according to which fee option the Grower elects for fees payable after the initial period, and where the Grower:

- participates in the Project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in the table below; and
- is not registered, nor required to be registered for GST.

Option 1 - Annual Lease and Management Fees

52. Where the Grower elects to pay fees annually, or fails to elect to prepay fees, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - fixed fee	8-1	\$2,200		
Primary Services - per Plantation Unit		\$2,200		
Planting Services - per Plantation Unit			\$220	
Annual Services - fixed fee	8-1		\$220	See notes (i) & (ii) below
Annual Services - per Plantation Unit			\$110	
Rent (lease fees) - per Plantation Unit	8-1		\$110 See note (i) below	See notes (i) & (ii) below
Interest	8-1	See note (iii) below	See note (iii) below	See note (iii) below

Notes:

- (i) Where a Grower incurs the Management Fees and Lease fees as required by the Lease and the Management Agreement, those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done within 13 months of the fees being incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraph 85 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than \$1,000, is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred.
- (ii) Rent and Annual Service fees are subject to indexation after the initial period. The amounts will be the prior year fee indexed at the annual rate of inflation.
- (iii) For a Grower using the finance option offered by ITC Finance Pty Ltd interest is deductible in full in the year in

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which it is incurred. The deductibility or otherwise of interest arising from agreements that Growers enter into with financiers other than ITC Finance Pty Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with ITC Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 84 to 93 below as those rules may be applicable if interest is prepaid.

Option 2 - Prepayment of Lease and Management Fees

53. Where the Grower elects on Application to prepay fees for a period of fifteen years, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - fixed fee	8-1	\$2,200		
Primary Services - per Plantation Unit		\$2,200		
Planting Services - per Plantation Unit			\$220	
Annual Services - fixed fee	8-1		\$330	\$330
Annual Services - per Plantation Unit			\$165 See note (iv) below	\$165 See note (iv) below
Rent (lease fees) - per Plantation Unit	8-1		\$165 See note (iv) below	\$165 See note (iv) below
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above

Notes:

- (iv) Where fees are prepaid beyond 13 months the amount and timing of the tax deductions is determined under subsection 82KZM(1) for 'small business taxpayers' or subsection 82KZMD(2) for taxpayers who are not 'small business taxpayers'. These subsections effectively use the same formula to apportion expenditure over the eligible service period or ten years whichever is the lesser (see paragraphs 88 to 89).

2002 Growers

54. A Grower may claim the deductions in one of the following tables according to which fee option the Grower elects for fees payable after the initial period, and where the Grower:

- participates in the Project by 30 June 2002 to carry on the business of afforestation;
- incurs the fees shown in the table below; and
- is not registered, nor required to be registered for GST.

Option 1 - Annual Lease and Management Fees

55. Where the Grower elects to pay fees annually, or fails to elect to prepay fees, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - fixed fee	8-1	\$2,200		
Primary Services - per Plantation Unit		\$2,200		
Planting Services - per Plantation Unit		\$220		
Annual Services - fixed fee	8-1	\$220	See notes (i) & (ii) above	See notes (i) & (ii) above
Annual Services - per Plantation Unit		\$110		
Rent (lease fees) - per Plantation Unit	8-1	\$110 See note (i) above	See notes (i) & (ii) above	See notes (i) & (ii) above
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above

Option 2 - Prepayment of Lease and Management Fees

56. Where the Grower elects on Application to prepay fees for a period of fifteen years, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - fixed fee	8-1	\$2,200		
Primary Services - per Plantation Unit		\$2,200		
Planting Services - per Plantation Unit		\$220		
Annual Services - fixed fee	8-1	\$330	\$330	\$330
Annual Services - per Plantation Unit		\$165 See note (iv) above	\$165 See note (iv) above	\$165 See note (iv) above

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Rent (lease fees) - per Plantation Unit	8-1	\$165 See note (iv) above	\$165 See note (iv) above	\$165 See note (iv) above
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above

Deductions where Growers are registered or required to be registered for GST

57. Where a Grower who is registered, or required to be registered for GST, participates in the Project and is entitled to an input tax credit, then the deductions will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 106.

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

58. For a Grower who invests in the Project and incurs expenditure as required by the Lease and the Management Agreement the following provisions of the ITAA 1936 have applications as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM except where the Grower has elected to prepay lease fees and Annual Services fees as shown in paragraphs 53 and 56 above (but also see paragraphs 90 to 93);
- expenditure by the Grower does not fall within the scope of sections 82KZMB - 82KZMD except where the Grower has elected to prepay lease fees and Annual Services fees as shown in paragraphs 53 and 56 above (but also see paragraphs 90 to 93);
- expenditure by the Grower does not fall within the scope of sections 82KZME - 82KZMF above (but see paragraphs 90 to 93)
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Division 35 - Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner’s discretion**

59. For a Grower who is an individual and who enters the Project during the years ended 30 June 2001 or 30 June 2002, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2015 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.

60. 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 76 in the Explanations part of this Ruling, below).

61. 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.

62. 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**Section 8-1**

63. Consideration of whether the lease and management fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

64. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the timber's sale from the scheme will constitute assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

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

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

66. For this Project Growers have, under the Lease agreement, rights over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Management Agreement Growers appoint the Responsible Entity to provide services such as planting, irrigating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for

the trees as and when required according to good silvicultural practice. Growers are considered to have control of their operations.

67. The Lease gives Growers an identifiable interest in specific trees and a legal interest in leased land. Growers have the right to personally market and sell the timber attributed to their Plantation Area or they may appoint ITCPM to arrange the marketing and sale of the timber for them. Growers will have a continuing interest in the trees.

68. Growers have the right to use the land in question for afforestation purposes and to have ITCPM come onto the land to carry out its obligations under the Constitution and the Lease and Management Agreements. The Growers' degree of control over the Responsible Entity, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on ITCPM's activities. Growers are able to terminate arrangements with ITCPM in certain instances, such as cases of default or neglect. The afforestation activities described in the Lease and the Management Agreement are carried out on the Growers' behalf.

69. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

70. Through ITCPM, Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

71. Growers have a continuing interest in the trees from the time they are acquired until harvest. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' afforestation activities will constitute the carrying on of a business.

72. The fees associated with the afforestation activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will, therefore, be deductible under paragraph 8-1(1)(a). Further, no

‘non-income producing’ purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under section 8-1 are met. The exclusions do not apply. Section 8-1 is however, subject to Division 27 of the ITAA 1997.

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

73. 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.

74. 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.

75. 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.

76. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities ‘of a similar kind’. Under subsection 35-10(4), there is an ‘Exception’ to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

77. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

78. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment in the Project of four Plantation Units is unlikely to pass one of the objective tests until the year ended 30 June 2016.

79. 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.

80. 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 interests 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) until the year ended 30 June 2015.

81. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised 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.

82. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 59) in the manner described in the Arrangement (see paragraphs 15 to 49), the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

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

- the report of the Independent Forester and additional expert or scientific evidence provided with the application by the Responsible Entity;
- independent, objective and generally available information relating to the Indian Sandalwood industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF

84. The prepayments provisions of the ITAA operate to spread over more than one income year, a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

85. The amount and timing of tax deductions for any prepaid management fees or prepaid lease fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the ‘eligible service period’ is, as defined in subsection 82KZL(1), in relation to these amounts. The ‘eligible service period’ means generally, the period over which the services are to be provided or 10 years, whichever is the lesser. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the ‘eligible service period’ exceeds 13 months, whether the Grower is a ‘small business taxpayer’. However, each prepayment provision uses the same, or effectively the same formula as that shown below concerning section 82KZMF.

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

Primary Services

86. For Growers that enter this Project during the year ended 30 June 2001, the Primary Services fees will be incurred on execution of the Lease and the Management Agreement. The fees are charged for providing management services to a Grower by 30 June of the year of execution of the Agreement. In particular, the Primary Services fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Primary Services fee has been inflated to result in reduced fees being payable for subsequent years.

87. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the Primary Services fee is for ITCPM doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements and as set out in paragraphs 29, 31 and 36 then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

Annual Services - Option 2

88. Growers may elect under Option 2 to prepay lease and management fees for the remaining life of the Project after the period ending on 30 June 2001. As the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure, for a Grower who is a 'small business taxpayer' subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a 'small business taxpayer' subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

89. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 85 above. However, the 'eligible service period' as defined in subsection 82KZL(1) is restricted to a maximum of 10 years after the day of the expenditure.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

90. Although not required under either the Management Agreement or the Lease, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 87 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

91. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula above at paragraph 85.

92. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then either section 82KZM or section 82KZMD will apply in the manner described at paragraphs 88 and 89 above.

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

Small business taxpayers

94. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

95. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

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

Interest deductibility

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

97. Some Growers may finance their participation in the Project through a loan facility with ITC Finance Pty Ltd. Under the terms of the Loan Agreement to be entered into between those Growers and ITC Finance Pty Ltd, interest must be paid.

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

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

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

100. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid for a period that is wholly or partly outside the income year in which the interest is incurred. Unless such prepaid interest is 'excluded expenditure' any tax deduction that may be allowable will be subject to the relevant prepayments provisions of the ITAA. 'Excluded expenditure' is an amount of expenditure of less than \$1,000.

101. The prepayment provisions are discussed in detail at paragraphs 84 to 93 of this Ruling. However, in broad terms, where interest is prepaid and the period to which the interest relates is wholly or partly outside the income year in which it is incurred, then any tax deduction that is allowable must be determined using the following formula:

Interest x Number of days of eligible service period in the year of income

Total number of days of eligible service period

In the formula, the ‘eligible service period’ means, generally, the period to which the interest relates.

Section 82KL

102. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

103. For Part IVA to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

104. The Project will be a ‘scheme’ commencing with the issue of the Prospectus. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 52 to 56 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

105. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm’s length, or, if any parties are not at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 – Entitlement to ‘input tax credit’

106. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following

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

$$\frac{1}{11} \times \$5,500 = \$500$$

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

Detailed contents list

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Commissioner of Taxation

14 February 2001

<i>Previous draft:</i>	- ITAA 1936 82KZMA
Not previously issued in draft form	- ITAA 1936 82KZMA(4)
	- ITAA 1936 82KZMB
	- ITAA 1936 82KZMC
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZMD
PR 98/1; PR 1999/95; TR 92/1;	- ITAA 1936 82KZMD(2)
TR 92/20; TR 97/11; TR 97/16;	- ITAA 1936 82KZME
TD 93/34; TR 98/22	- ITAA 1936 82KZME(7)
	- ITAA 1936 82KZMF
<i>Subject references:</i>	- ITAA 1936 Pt IVA
- carrying on a business	- ITAA 1936 177A
- commencement of business	- ITAA 1936 177C
- fee expenses	- ITAA 1936 177D
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- management fees	- ITAA 1997 6-5
- producing assessable income	- ITAA 1997 8-1
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- taxation administration	- ITAA 1997 Div 27
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- tax shelters	- ITAA 1997 35-10
- tax shelters project	- ITAA 1997 35-10(2)
	- ITAA 1997 35-10(3)
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<i>Legislative references:</i>	- ITAA 1997 35-30
- ITAA 1936 82KL	- ITAA 1997 35-35
- ITAA 1936 82KZL	- ITAA 1997 35-40
- ITAA 1936 82KZL(1)	- ITAA 1997 35-45
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- ITAA 1997 35-55(1)(a)
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