

PR 2001/20 - Income tax: Campbells River Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *14 March 2001*



Product Ruling

Income tax: Campbells River Project

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	35
Explanations	50
Examples	88
Detailed contents list	89

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

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

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

Tax law(s)

2. The tax law(s) 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);
 - Section 82KZMD (ITAA 1936);
 - Section 82KZME – 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

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 enter into the arrangement described below on or after the date this Ruling is made. 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 the Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 14 March 2001, the date the 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).

12. 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, the Product 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 2003. 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

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

- Application for Product Ruling for the Campbells River Project dated 14 November 2000;

- Prospectus of the Campbells River Project dated 7 September 2000 lodged with the Australian Securities and Investment Commission received with the application for Product Ruling;
- **Project Agreement of the Campbells River Project between Mount David Forestry Limited (“MDF”, “Responsible Entity”) and each Grower, received with the application for Product Ruling;**
- **Deed of Amendment to the Project Agreement between MDF and each Grower received on 28 February 2001;**
- Compliance Plan of the Campbells River Project received with the application for Product Ruling;
- Constitution of the Campbells River Project dated June 2000;
- Constitution of Mount David Forestry Limited received with the application for Product Ruling;
- Option To Lease Agreement between David Max Taylor (“Grantor”) and MDF (“Grantee”) dated 7 September 2000;
- Lease Agreement between David Max Taylor and MDF received with the application for Product Ruling;
- Agreement between MDF and Oberon Forest Developers Pty Ltd dated 25 October 2000;
- Deed of Agreement between Mount David Group Pty Ltd (“MDG”) Mount David Forestry Limited dated 28 February 2001;
- Correspondence from the applicant’s representative dated 15 December 2000 and 28 February 2001.

Note: certain information received from Mount David Forestry Limited 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 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

16. This arrangement is called the Campbells River Project.

Location	Oberon, New South Wales
Type of business each participant is carrying on	Commercial growing of <i>Pinus radiata</i> for the purpose of harvesting and selling of timber
Number of hectares under cultivation	800
Size of each Stand	0.4 hectare
Expected production	60, 40 and 160 cubic metres per Stand at years 15, 24 and 28 respectively
Term of the investment	28 years
Initial cost	\$3,190 per Stand
Initial cost per hectare	\$7,975
Ongoing costs	Licence and Supervision Fees of \$110 and \$33 per annum respectively (subject to CPI indexation after Year 3); Clearfall Harvesting Supervision Fee of 3% of the Grower's gross return; Optional Special Management Activities Fees as negotiated with the Responsible Entity.

17. Growers participating in the arrangement enter into the Project Agreement providing for a licence of land, forest development and ongoing supervision for the term of the Project, which is estimated to be 28 years.

18. Each Grower must subscribe for a minimum of 5 Stands of 0.4 hectares each i.e., a minimum area of 2 hectares. Under the Project Agreement MDF will, on behalf of the Grower, plant and cultivate *Pinus radiata* seedlings at an appropriate stocking rate in accordance with sound silvicultural practices and will undertake to replant dead seedlings where more than 10% have died in the first 12 months. Ownership of the trees remains the property of the Grower (unless the licence is terminated for non payment of annual licence fees). Three harvest periods are scheduled over the life of the Project, the first in approximately 15 years and the second in approximately 24 years with eventual clearfall to occur in approximately 28 years.

19. The projected returns depend on a range of assumptions and MDF does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project Agreement being offered pursuant to the Prospectus.

20. Under the Prospectus MDF proposes to offer 2000 Stands of 0.4 hectares each at a cost of \$3,190 per Stand. Ongoing annual licence fees and maintenance fees are payable by the Grower. There is no minimum subscription that must be raised under the Prospectus. However certain costs of the Project have been underwritten by MDG. Under the Deed of Agreement between MDG and MDF, MDG acknowledges that it will not demand either repayment for expenses underwritten pursuant to clause 2.1 of the Deed or remuneration for any services rendered until the Campbells River Project reaches the subscription level of 200 Stands, or all the directors of MDF agree that such remuneration is able to be made without jeopardising the stability of MDF and the Campbells River Project and only after the directors of MDF are satisfied that, as directors of the RE, they have placed the interests of the Growers of the Campbells River Project first. MDF reserves the right to accept oversubscriptions.

21. The land available to the Project has been secured by an option to lease from related parties, which expire on 30 June 2002 as follows:

Property	Approx. Area
Greenhills	140 hectares
Shannon	230 hectares
Toondullie	675 hectares

Formal leases for a term of 30 years will be executed as property is required for the Project.

Project Agreement

22. The Project Agreement encompasses the licence to use the land, plantation preparation and management, planting and administration, ongoing maintenance and supervision, and marketing.

23. Growers enter into a licence to use the land for the sole purpose of conducting a forestry business for the term of the Project. The Licence is conditional on the Grower establishing the business, paying the annual licence fees and supervision fees and paying any Special Management fees or Plantation Maintenance fees that are payable during the life of the Project.

24. The performance of forest development works is dependant upon the timing of entry into the project. Planting of seedlings can only occur in certain conditions generally between June and October each year. For this reason Growers accepted up to and including 31 May 2001 will have completed preliminary cultivation and acquisition of seedlings prior to 30 June 2001. The planting service period will not commence before 1 July 2001.

25. For Growers accepted into the Project after 31 May 2001, preliminary cultivation and acquisition of seedlings will be undertaken both before and after 30 June 2001. In all cases the performance of this service by the Responsible Entity will take a minimum of 30 days and will extend across the end of the financial year. Accordingly, expenditure in relation to Plantation Preparation and Management will need to be apportioned and will not be fully deductible in the year ended 30 June 2001. Growers will be provided with separate invoices detailing the number of days in the 'eligible service period' in the first and second expenditure years. Planting of seedlings for these Growers will not be commenced before 1 July 2001.

26. MDF will develop the Stands for the Grower, including all land preparation, chemicals fertilisers and supply of seedlings, in accordance with sound silvicultural practices. Each Grower will receive a map of the Project clearly identifying the area allocated. MDF will also supervise the plantation for the term of the Project including maintenance of fire trails and access roads, regular site visits, maintenance of identifying markers, basic supervision etc. for which it will receive an annual fee.

27. MDF will also identify any Special Management activities (SMAs) or Plantation Maintenance activities which may be required or recommended. SMAs are optional and will be at the Growers' discretion (e.g., pruning). MDF will charge a separate fee in respect of these activities if required. Growers are responsible for their own insurance requirements.

28. Growers may elect to collect their own timber at clearfall however thinnings will be conducted by MDF. Growers may elect to appoint MDF as their agent to conduct the clearfall harvest and to negotiate the best possible commercial price. Clearfall must occur prior to the expiration of the term of the Project.

Fees

29. The plantation preparation and management fee, planting and administration fee and the Year 1 licence fee are payable on application. The licence fee for Years 3 and beyond are due and payable on 30 April in advance and the supervision fee for Years 2 and beyond are payable in arrears.

30. The following fees are payable in the year indicated where Growers are accepted into the Project before 30 June 2001.

	Year 1 (Year Ended 30 June 2001)	Year 2 (Year Ended 30 June 2002)	Year 3 (Year Ended 30 June 2003)
Plantation Preparation and Management fee	\$2,558		
Planting and Administration fee	\$522		
Licence fee	\$110	\$110	\$110
Supervision fee		\$33	\$33

31. For those Growers who are accepted into the Project from 1 July 2001, the fees payable for Year Ended 30 June 2002 are those shown above as Year 1 and the fees payable for Year Ended 30 June 2003 are those shown above as Year 2.

32. The Application monies will be held by the custodian until released to MDF on acceptance of application to enable plantation development.

Finance

33. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

34. 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' 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 are involved, or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable Income

35. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Deductions where a Grower is not registered nor required to be registered for GST

36. A Grower may claim tax deductions using the methods and Tables in paragraphs 37-40, where the Grower,

- **participates in the Project by 30 June 2002** to carry on the business of growing *Pinus radiata*;
- incurs the fees shown in paragraph 30; and
- is not registered nor required to be registered for GST.

Section 8-1 – Fees

37. Some expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, a Grower who prepays this fee **cannot** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless the eligible service period falls within the year of income (as explained below) or it is 'excluded expenditure' (see Note (ii) below).

38. The amount and timing of tax deductions allowable each year for prepaid fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the 'eligible service period' means, generally, the period over which the services are to be provided.

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

39. The deduction for the plantation preparation and management fee for Growers who invest in the Project after 31 May 2001 but before 1 July 2001 for the years ended 30 June 2001 and 2002 must be calculated by applying the formula in paragraph 38 above.

40. For a Grower who invests in the Project before 31 May 2001 the following deductions are available:

Fee type	ITAA 1997 section	Year Ended 30 June 2001	Year Ended 30 June 2002	Year Ended 30 June 2003
Plantation Preparation and Management fee	Section 8-1	\$2,558		
Planting and Administration fee	Section 8-1		522 See notes (i) & (ii) below	
Licence fees	Section 8-1	\$110 – see notes (i), (ii) & (iv) below	\$110 – see notes (i), (ii) & (iv) below	\$110 – see notes (i), (ii) & (iv) below
Supervision fees	Section 8-1		\$33	\$33
Interest	Section 8-1	See notes (ii), (iii) & (iv) below	See notes (ii), (iii) & (iv) below	see notes (ii), (iii) & (iv) below

Notes:

- (i) None of the Planting and Administration fee will be deductible in the year incurred as there is no eligible service period in the year ended 30 June 2001, and the prepaid expenditure does not qualify as ‘excluded expenditure’ as a Grower is required to subscribe for a minimum of 5 stands (see Note (ii)). The licence fees, being amounts of less than \$1,000 in each expenditure year, constitute ‘excluded expenditure’. However, where a Grower acquires more than one interest in the Project and the quantum of these prepaid fees is more than \$1,000, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.
- (ii) Amounts of less than \$1,000 will be ‘excluded expenditure’. Excluded expenditure is an ‘exception’ to the prepayment rules and is deductible in full in the year in which it is incurred. Deductibility of amounts of \$1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined using the formula shown above (in paragraph 38).
- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their

participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 65 to 67 below as those rules may be applicable if interest is prepaid.

- (iv) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 68 to 70). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

41. **For a Grower who invests in the Project between 1 June 2001 and 30 June 2001**, the tax deductions available are the same as those shown in paragraph 39 except that the deduction for the Plantation Preparation and Management fee is not fully deductible in Year 1. Instead that fee is subject to the prepayment rules contained in sections 82KZME and 82KZMF.

Fee type	ITAA 1997 section	Year Ended 30 June 2001	Year Ended 30 June 2002	Year Ended 30 June 2003
Plantation preparation and Management fee	Section 8-1	Amount must be calculated – see note (i) above	Amount must be calculated – see note (i) above	
Planting and administration fee	Section 8-1		522 – see notes (i) & (ii) above	
Licence fees	Section 8-1	\$110 – see notes (i), (ii) & (iv) above	\$110 – see notes (i), (ii) & (iv) above	\$110 – see notes (i), (ii) & (iv) above
Supervision fees	Section 8-1		\$33	\$33
Interest	Section 8-1	See notes (ii), (iii) & (iv) above	See notes (ii), (iii) & (iv) above	See notes (ii), (iii) & (iv) above

42. For a Grower who invests in the Project after 30 June 2001, the following deductions are available:

Fee type	ITAA 1997 section	Year Ended 30 June 2002	Year Ended 30 June 2003
Plantation preparation and management fee	Section 8-1	\$2,558	
Planting and Administration fee	Section 8-1	\$522	
Licence fees	Section 8-1	\$110 – see notes (i), (ii) & (iv) above	\$110 - see notes (i), (ii) & (iv) above
Supervision fees	Section 8-1		\$33
Interest	Section 8-1	See notes (ii), (iii) & (iv) above	See notes (ii), (iii) & (iv) above

Deductions where a Grower is registered or required to be registered for GST

43. Where a Grower who is registered or required to be registered for GST:

- participates in the Project by 30 June 2002 to carry on the business of growing *Pinus radiata*;
- incurs the fees shown in paragraph 30; and
- is entitled to an input tax credit for the fees,

then the tax deductions calculated using the methods and Tables in paragraphs 37 - 42 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example at paragraph 86.

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

44. 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 2014 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.

45. 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 77 in the Explanations part of this ruling, below).

46. 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 his/her 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.

47. 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.

Section 82KL

48. Section 82KL does not apply to deny the deduction otherwise allowable.

Part IVA

49. 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.

Explanations

Section 8-1

50. Consideration of whether the plantation preparation and management fee, planting and administration fee, licence fees and

supervision fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing 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 himself/herself 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?

51. A timber growing scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds from timber from stands comprising the Project will constitute gross 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 timber each year from the stand.

52. Generally, a Grower will be carrying on a business of timber growing where:

- the Grower has an identifiable interest in specific trees coupled with a right to harvest and sell the timber each year from the trees;
- the timber growing activities are carried out on the Grower'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.

53. For this Project Growers have rights under the Project Agreement in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing trees.

Under the Project Agreement Growers engage the responsible entity to acquire *Pinus radiata* seedlings and plant out the seedlings on the licensed land and to provide ongoing services to care and maintain the trees. Growers are considered to have control of their operations.

54. The Project Agreement provides Growers with more than a chattel interest in the trees. The Project documentation contemplates Growers will have an ongoing interest in the trees.

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

56. 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.

57. 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 timber growing practices and are of the type ordinarily found in timber growing ventures that would commonly be said to be businesses.

58. Growers have a continuing interest in the trees from the time they are acquired until the cessation of the Project. The timber growing 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' timber growing activities will constitute the carrying on of a business.

59. The plantation preparation and management fee, planting and administration fee, licence fees and supervision fees associated with the timber growing activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the sale of timber) is to be gained from the business. They will thus be deductible under the first limb of section

8-1. Further, no ‘non-income producing’ purpose in incurring the fees is identifiable from the arrangement. The fees appear to be reasonable. There is no capital component of the fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Sections 82KZME and 82KZMF – Prepaid fees

60. Expenditure prepaid by Growers for the plantation preparation and management fee, planting and administration fee and licence fees meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an ‘agreement’ as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

61. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and
- have ‘eligible service periods’ (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The ‘eligible service period’ (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

62. In relation to an ‘agreement’ referred to in subsection 82KZME(3), the Project is an ‘agreement’ (this being a broad concept under subsection 82KZME(4)), where, during the term of this Product Ruling:

- the Grower’s allowable deductions attributable to the Project for each expenditure year exceeds the Grower’s assessable income from the Project (if any) for the expenditure year; and
- the Grower does not have day-to-day control over the operation of the Project; and
- there is more than one Grower participating in the Project.

63. The prepaid plantation preparation and management fee incurred by Growers who invest in the Project after 31 May 2001 and

before 1 July 2001 does not fall within any of the 5 exceptions to section 82KZME and, therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the fee over the period that the services for which the prepayment is made are performed. None of the Planting and Administration fee will be deductible in the year incurred as there is no eligible service period in the year ended 30 June 2001, and the prepaid expenditure does not qualify as 'excluded expenditure' as a Grower is required to subscribe for a minimum of 5 stands.

64. The licence fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of these prepaid fees is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Interest deductibility

65. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier 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.

66. 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. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

67. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. The relevant formula is shown above in paragraph 38.

Prepayments where the eligible service period exceeds 13 months

68. Although not required under the Arrangement described in this Product Ruling, some Growers may choose to prepay some or all of their fees for periods longer than the agreements require. Specifically, this will occur when the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure. Where the 'eligible service period' exceeds 13 months sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

69. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 71 to 73), 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.

70. 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 38 (above). However, expenditure, which is 'excluded expenditure', is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for 'excluded expenditure' can be claimed in full in the year in which the expenditure is incurred.

Small business taxpayers

71. 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.

72. '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).

73. 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'.

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

74. 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.

75. 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.

76. 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.

77. 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.

78. 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).

79. 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 of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2028. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

80. 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.

81. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) until the year ended 30 June 2014. 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; 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 44), in the manner described in the Arrangement (see paragraphs 14 to 34), 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 this conditional basis, the Commissioner has relied upon:

- the report of the independent professional forester provided with the application by the responsible entity;

- independent, objective, and generally available information relating to the pine plantation industry provided by the Responsible Entity; and
- research undertaken by officers of the Australian Taxation Office.

Section 82KL

84. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(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 - general tax avoidance provisions

85. 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).

86. The Campbell’s River Project will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

87. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the timber. 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 is 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.

Examples

Entitlement to ‘input tax credit’

88. 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' showing its ABN and the price of the taxable supply for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

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

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

Paragraph

What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	16
Project Agreement	22
Fees	29
Finance	33
Ruling	35
Assessable income	35

PR 2001/20

Deductions where a Grower is not registered nor required to be registered for GST	36
Section 8-1 – Fees	37
Deductions where a Grower is registered or required to be registered for GST	43
Division 35 – Deferral of losses from non-commercial business activities	44
Section 82KL	48
Part IVA	49
Explanations	50
Section 8-1	50
Is the Grower carrying on a business?	51
Sections 82KZME and 82KZMF – Prepaid fees	60
Interest deductibility	65
Prepayments where the eligible service period exceeds 13 months	68
Small business taxpayers	71
Division 35 – Deferral of losses from non-commercial business activities	74
Section 82KL	84
Part IVA – general tax avoidance provisions	85
Example	88
Entitlement to ‘input tax credit’	88
Detailed contents list	89

Commissioner of Taxation

14 March 2001

<i>Previous draft:</i>	- commencement of a business
Not previously issued in draft form	- interest expenses
	- harvesting expenses
<i>Related Rulings/Determinations:</i>	- management fees
PR 1999/95; TR 92/1; TR 97/11;	- primary production
TR 97/16; TR 92/20; TR 98/22;	- primary production expenses
IT 175; TD 93/34	- producing assessable income
	- product rulings
<i>Subject references:</i>	- public rulings
- carrying on a business	- schemes

- tax avoidance
- tax benefits

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- 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(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350

- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZM(1)(b)(ii)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
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- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)

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