

PR 2001/79 - Sandalwood and Mango Project 2001

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! This document has changed over time. This is a consolidated version of the ruling which was published on *6 June 2001*



Product Ruling

Income tax: Sandalwood and Mango 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 in future years to confirm the arrangement has been implemented as described below and to ensure that 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 referred to as the 'Sandalwood and Mango Project 2001', or just simply as 'the Project'.

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);
 - Part 2-25 (ITAA 1997);
 - section 387-55 (ITAA 1997);
 - section 387-125 (ITAA 1997);
 - section 387-165 (ITAA 1997);
 - section 388-55 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZL (ITAA 1936);
 - section 82KZM (ITAA 1936);
 - sections 82KZMB - 82KZMD (ITAA 1936);
 - sections 82KZME - 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling 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 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.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 45) 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
- the Ruling will be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 6 June 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 13 February 2001;
- Draft Prospectus to be issued by Kimberley Plantations Ltd ('Responsible Entity'), undated, received 13 February 2001;
- Draft Constitution for the Sandalwood and Mango Project 2001, undated, received 13 February 2001;
- Draft **Management Agreement** between Kimberley Plantations Management Pty Ltd (the 'Manager') and the Grower, undated, received 16 May 2001;
- Draft **Sub-Lease Agreement** between Kimberley Plantations Holdings Pty Ltd (the 'Lessee') and the Grower, undated, received 16 May 2001;
- Draft Compliance Plan for the Sandalwood and Mango Project 2001, undated, received 14 May 2001;
- Custodian Agreement between Kimberley Plantations Ltd ('Responsible Entity') and the Custodian, undated, received 14 May 2001; and
- Additional correspondence from the Applicant dated 4 April 2001, 10 May 2001, 14 May 2001 and 22 May 2001.

Note: certain information 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.

PR 2001/79**Overview**

17. This arrangement is called the Sandalwood and Mango Project 2001. The salient features are as follows:

Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of: <ul style="list-style-type: none"> • Indian Sandalwood (<i>Santalum album</i>) trees for the purpose of harvesting and selling the timber; • Mangoes for the purpose of harvesting and selling fruit.
Number of hectares offered for cultivation	180 hectares (1,600 Woodlots)
Size of each Woodlot	0.1125 hectares comprising 625m ² for Sandalwood and 500m ² for Mangoes
Minimum investment	1 Woodlot
Minimum subscription	400 Woodlots
Number of trees established per hectare	Sandalwood – 640; Mango - 200
Expected production	Sandalwood - 22,400 kg per hectare; Mangoes - commencing at 3,000 kg per hectare in year 3, increasing to 22,500 kg per hectare in year 8.
The term of the investment	Approximately 15 years
Initial cost	\$5,500
Initial cost per hectare	\$48,888
Ongoing and other costs	Sub-Lease and Management Fees payable annually and additional fees payable from harvest proceeds.

18. The Project will be registered as a Managed Investment Scheme under the Corporations Law. The Responsible Entity for this Project is Kimberley Plantations Ltd ('KPL'). Growers participating in the arrangement will enter into a Sub-Lease Agreement. The Agreement provides for the Sub-Lease of the project land at 'Kingston Rest' located near the town of Kununurra in Western Australia, being a portion of:

- (a) King Location 338 contained in Certificate of Title Volume 1669 Folio 655; and

- (b) King Location 344 contained in Certificate of Title Volume 1918 Folio 306.

19. Under this agreement, Growers lease an area of land called a 'Woodlot' until the date the final distribution of the sale proceeds is made, or until the Project is terminated, if earlier. The Project is for a term of approximately 15 years. The project land will be divided into distinct areas for growing Indian Sandalwood and Mangoes. Each Woodlot will consist of two areas totalling 0.1125 hectares and will be planted with Indian Sandalwood seedlings at a rate of 640 trees per hectare and Mango trees at a rate of 200 trees per hectare. Overall, it is proposed to plant 1,600 Woodlots. These Woodlots are separately identified in a plan of the Plantation.

20. There is a minimum subscription of 400 Woodlots for this Project. Under the Prospectus, Growers that enter the Project on or before 15 June 2001 will be classed as '2001 Growers'. Growers that commence participation in the Project after 15 June 2001 will be classed as '2002 Growers'. The Responsible Entity undertakes to ensure that all services required to be performed will be completed in relation to Woodlots of 2001 Growers in the Initial Period to 30 June 2001. If the minimum subscription is not reached by 15 June 2001 the Project will not commence in the 2000/2001 income year and KPL will immediately refund the application monies received.

21. Following this, all investors shall be given the opportunity to participate in the Project as 2002 Growers on the basis that if the minimum subscription is not achieved during the 2001/2002 income year all application monies shall be refunded and the Project will not proceed.

22. The Growers will also enter into a contract with the Manager for the management of their Woodlot. The Manager will be responsible for establishing and cultivating the trees and harvesting, processing and selling the produce.

23. Harvesting of the Indian Sandalwood will take place towards the end of the Project and is expected to be completed in the final year of the Term. The Mango is an annual crop and will be harvested each year commencing in the year ending 30 June 2004. Yields will increase as the Mango trees mature.

24. Growers may elect to harvest and sell their own Produce by replying to a Harvest Notice issued by the Manager when the Crop is ready to be harvested ('Electing Grower'), or the Manager will harvest and sell the Produce on their behalf ('Non-Electing Grower') for the highest possible price (clause 6 of the Management Agreement).

Constitution

25. 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 KPL agrees to act as Responsible Entity and thereby manage the Project as the operator of a Managed Investment Scheme registered pursuant to the Corporations Law. The Sub-Lease and the Management Agreement will be executed on behalf of a Grower following them signing the Application Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

26. The Responsible Entity will:

- prepare the Sub-Lease Agreement and Management Agreement (clause 13.5);
- ensure that application moneys are not released until the appropriate agreements are in place (clause 14);
- keep a register of Growers (clause 16); and
- distribute profits (clause 12.4).

Compliance plan

27. KPL has prepared a Compliance Plan as required by the Corporations Law. 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.

Head Lease

28. The owner of the land has agreed to lease an area of land to Kimberley Plantations Holdings Pty Ltd (the 'Lessee') in order to conduct the Project. The Lessee is entitled to use the land for the establishment of a Sandalwood and Mango plantation and to sub-lease the land in Woodlots for the purpose of a Managed Investment Scheme. The Head Lease Agreement is subject to the Responsible Entity achieving minimum subscription under the Prospectus and obtaining approvals for the land to be used as a tree plantation.

Interest in Land

29. Growers participating in the arrangement will enter into a Sub-Lease between Kimberley Plantations Holdings Pty Ltd as 'Lessee' and the Grower as a 'Sub-Lessee'. Growers are granted an

interest to use their Woodlot for the purpose of cultivating and harvesting trees upon terms and conditions as set out in the Sub-Lease.

30. Each Grower must pay rent to the Lessee during the Term of the Project in an amount specified in Clause 5 of the Sub-Lease Agreement.

Management Agreement

31. Each Grower will enter into a Management Agreement with Kimberley Plantations Management Pty Ltd as the Manager of the Project to perform services under the Agreement. The appointment of the Manager is for the purpose of overseeing the management of the scheme and to provide management services for the establishment of the plantation, nurturing of the crops situated on the Woodlot and the eventual harvest and sale of the produce. Clause 3 of the agreement specifies the services to be performed by the Manager. The Manager will supervise and manage all horticultural and forestry activities on behalf of the Grower and must:

- conduct land preparation and construct and establish an irrigation system on each Woodlot;
- supply and plant seedlings and replace any seedlings that fail to establish within six months of planting;
- supply adequate water and provide general care and maintenance in accordance with good agro-forestry practice; and
- maintain and ensure the continued operation of the irrigation system, access roads, firebreaks and pest and weed control programme.

32. The Manager shall be entitled to remuneration for the performance of its duties under the Management Agreement. The amount payable to the Manager on Application totals \$5,307.50 comprising a Management Fee of \$3,850, \$742.50 for Irrigation, \$220 for Mango trees and \$495 for Planting costs. Annual fees are also payable under the agreement.

33. Growers will share the sales proceeds on a proportionate basis, following the payment of harvest costs and any amounts due and payable by the relevant Grower.

Fees

34. The fees payable under the Management Agreement and the Sub-Lease Agreement on a per Woodlot basis are as follows:

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- Management Fee of \$3,850 payable to the Manager on Application for the period from the Commencement Date to 30 June in the financial year in which the Commencement Date falls (defined as the ‘Initial Period’);
- Irrigation fee of \$742.50 payable to the Manager on Application for the costs of supplying and installing an irrigation system on the Woodlot in the Initial Period;
- A fee of \$220 payable to the Manager on Application for the cost of supplying Mango trees in the Initial Period;
- Planting fee of \$495 payable to the Manager on Application for planting Sandalwood seedlings and Mango trees by 30 September in the year following the Initial Period;
- Management Fee of \$962.50 for the second year, (being the financial year after the Initial Period), payable to the Manager within 14 days of the Manager’s invoice which shall be rendered within 30 days of the first anniversary of the Commencement Date;
- In each subsequent year, a Management Fee is payable to the Manager within 14 days of the Manager’s invoice which shall be rendered within 30 days of each anniversary of the Commencement Date during the Term. The amount will be the fee in the preceding year indexed at the greater of 3% per annum or the annual rate of inflation;
- Rent of \$192.50 payable to the Lessee on Application for the first year (being 12 months commencing from the Commencement Date);
- Rent of \$192.50 for the second year, (being 12 months commencing on the first anniversary of the Commencement Date), payable to the Lessee within 14 days of the Lessee’s invoice which shall be rendered within 90 days of the first anniversary of the Commencement Date; and
- In each subsequent year, Rent is payable to the Lessee within 14 days of the Lessee’s invoice which shall be rendered within 90 days of each anniversary of the Commencement Date during the Term. The amount will be the Rent in the preceding year indexed at the greater of 3% per annum or the annual rate of inflation.

35. Non-Electing Growers are also required to pay to the Manager an amount equal to 5.5% of the Gross Sales Proceeds for additional management and administration costs associated with harvesting and marketing (clause 6.2).

36. The Manager will endeavour to, if so requested, arrange insurance for the Grower's Woodlot on behalf of the Grower. The cost of such insurance will be at the expense of the Grower (clause 3.6).

37. 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 Account in the name of the Responsible Entity. The Application Money will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 11 of the Constitution).

Planting

38. Under the Management Agreement, the Manager will supply the necessary seedlings and host trees. The Manager will be responsible for planting the seedlings on the Woodlots by 30 September 2001 for 2001 Growers and by 30 September 2002 for 2002 Growers. The Manager will replace any seedlings that fail to establish within six months of planting. The Manager will then maintain the trees in accordance with good agro-forestry practice. The services to be provided by the Manager over the term of the Project are outlined in clause 3 of the Management Agreement.

Harvesting and sale

39. The Grower has full right, title and interest in the Crop and Produce at all times and the right to have the Produce sold for their benefit.

40. The Mango trees will produce an annual crop and will be harvested every year commencing during the year ending 30 June 2004. The Indian Sandalwood is expected to be harvested at the end of the Project in the year ending 30 June 2016 (2001 Growers) or 30 June 2017 (2002 Growers) but will take place as and when deemed appropriate by the Manager in producing the best overall result for the Grower.

41. A Harvest Notice will be issued by the Manager at the time determined that the Crop is ready to be harvested. Unless the Grower elects to harvest and sell their own Produce, the Manager will be responsible for arranging the marketing and sale of the Produce. The

Manager is only required to send a Harvest Notice for the first Mango harvest and the election shall stand for the remainder of the Project.

42. Electing Growers must notify the Manager in writing within 30 days of the anticipated time that the Grower intends to harvest its Crop, which must be prior to the expiration of the Term. All outstanding management fees, charges and expenses entitled to be deducted from sales proceeds must be accounted to the Manager on or before the date the Electing Grower harvests its Woodlot.

43. The proceeds from sale of the Growers produce will be paid direct to the Responsible Entity who must deposit them into a Sales Proceeds Account. The Responsible Entity may deduct any amounts payable by a Grower under the Sub-Lease Agreement or Management Agreement. Growers will then be distributed the appropriate amount based on their proportionate interest in the Project less any authorised deductions.

Finance

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

45. 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;
- entities associated with the Project are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest 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; or

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Assessable income

46. A Grower's share of the Gross Sales Proceeds derived from the sale of fruit and timber harvested from the Project, less any GST payable on these proceeds, will be assessable income 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.

47. Once harvested, a Grower's fruit or timber will be trading stock of the Grower. As a consequence, if fruit or timber is on hand at the end of an income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of the ITAA 1997. Each Grower will be notified by the Manager of the relevant amounts to be brought to account in respect of their proportional interest in the Project, in accordance with Part 2-25.

Minimum subscription

48. A Grower will not incur the fees shown in the Tables(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the Prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 400 Woodlots is achieved. Tax deductions are not allowable until these requirements are met. No deductions shall be allowable in the 2000/2001 income year if the minimum subscription is not reached by 15 June 2001.

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

2001 Growers

49. A Grower may claim tax deductions using the method and table in paragraphs 50 to 52, on a per Woodlot basis, where the Grower:

- participates in the Project by 15 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 34; and

- is not registered nor required to be registered for GST.

Section 8-1 - prepaid fees

50. 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 fees that are otherwise allowable under section 8-1 cannot claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is 'excluded expenditure' (see note (ii) below).

51. The amount and timing of tax deductions allowable each year for such 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.

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

52. In this Project, Planting and Sub-Lease Fees (Rent) are required to be prepaid. Where a number of interests are acquired and fees for these items separately total \$1,000 or more in an income year, tax deductions allowable for Planting and Sub-lease fees (detailed at paragraph 34 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 108 and 109.

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Second Year 30/6/2002	Third Year 30/6/2003	Fourth Year 30/6/2004
Management Fee	8-1	\$3,850	\$962.50 see note (i) below	\$962.50 (indexed) see notes (i) and (iii) below	\$962.50 (indexed) see notes (i)& (iii) below
Sub-Lease Fee (Rent)	8-1	see note (ii) below	see notes (i) and (ii) below	see notes (ii), (vi) & (iii) below	see notes (ii), (vi) & (iii) below
Planting	8-1	see note (iv) below	see note (iv) below		
Interest	8-1	see note (v) below	see note (v) below	see note (v) below	see note (v) below

Notes:

- (i) Where a Grower incurs the Management fees as required by 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 (eg, the provision of management services) that will not be wholly done in the same income year as the fees are 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 51.
- (ii) Sub-lease fees totalling 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 (See Example 3 at paragraph 109). 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 51 (see Example 2 at paragraph 108). The Project Manager will inform Growers of the number of days in the eligible service period in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred.
- (iii) The sub-lease and management fees are subject to indexation after the second year. The amounts will be the fee in the preceding year indexed at the greater of 3% per annum or the annual rate of inflation.
- (iv) Where a Grower invests in either one or two Woodlots and pays the Planting Fee on application during the year ending 30 June 2001, the amount will be deductible in full as 'excluded expenditure'. However, where a Grower invests in three or more Woodlots, the tax deduction for the prepaid Planting Costs fee **MUST** be determined using the formula shown in paragraph 51.
- (v) 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 72 to 79 below as those rules may be applicable if interest is prepaid.

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- (vi) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of the 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 77 to 79). To apportion the expenditure over the eligible service period, these provisions which apply respectively to 'small business taxpayers', effectively use the same formula as that shown above.

Tax deductions for capital expenses

53. A Grower who participates in the Project by 15 June 2001 will also be entitled to the following tax deductions per Woodlot:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Second Year 30/6/2002	Third Year 30/6/2003	Fourth Year 30/6/2004
Irrigation	387-125	\$247 see notes (vii) & (viii) below	\$247 see notes (vii) & (viii) below	\$247 see notes (vii) & (viii) below	nil see note (vii) below
Establishment of Horticultural Plants	387-165	nil see note (ix) below	nil see note (ix) below	nil see note (ix) below	see note (ix) below

Notes:

- (vii) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.
- (viii) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.
- (ix) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the trees for use in a horticultural

business. The deduction is allowable when the trees, as horticultural plants, enter their first commercial season. If the trees have an 'effective life' for the purposes of section 387-185 of '30 years or more', this results in a write-off rate of rate of 13% prime cost. The Project's Responsible Entity will inform Growers of when the trees enter their first commercial season.

2002 Growers

Section 8-1

54. A Grower may claim tax deductions using the method at paragraphs 50 to 52 and the tables below, on a per Woodlot basis, where the Grower:

- participates in the Project by 30 June 2002 to carry on the business of afforestation;
- incurs the fees shown in paragraph 34; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Second Year 30/6/2003	Third Year 30/6/2004
Management Fee	8-1	\$3,850	\$962.50 see note (i) above	\$962.50 (indexed) see notes (i) & (iii) above
Sub-Lease Fee (Rent)	8-1	see note (ii) above	see note (ii) above	see notes (ii) & (iii) above
Planting	8-1	see note (x) below	see note (x) below	
Interest	8-1	see note (v) above	see note (v) above	see note (v) above

Notes:

- (x) Where a Grower invests in either one or two Woodlots and pays the Planting Fee on application during the year ending 30 June 2002, the amount will be deductible in full as 'excluded expenditure'. However, where a Grower invests in three or more Woodlots, the tax deduction for the prepaid Planting Costs fee **MUST** be determined using the formula shown in paragraph 51.

PR 2001/79***Tax deductions for capital expenses***

55. A Grower who participates in the Project by 30 June 2002 will also be entitled to the following tax deductions per Woodlot:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Second Year 30/6/2003	Third Year 30/6/2004
Irrigation	387-125	\$247 see notes (vi) & (vii) above	\$247 see notes (vi) & (vii) above	\$247 see notes (vi) & (vii) above
Establishment of Horticultural Plants	387-165	nil see note (viii) above	nil see note (viii) above	nil see note (viii) above

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

56. 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 afforestation;
- incurs the fees shown in paragraph 34; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables above will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 107.

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

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

- expenditure by the Grower on Management Fees does not fall within the scope of section 82KZM (but also see paragraphs 77 to 79);
- expenditure by the Grower on Management Fees does not fall within the scope of section 82KZMD (but also see paragraphs 77 to 79);
- expenditure by the Grower on Management Fees does not fall within the scope of sections 82KZME - 82KZMF above;

- 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

58. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 to become a 2001 Grower, 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 2006 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. Similarly for a 2002 Grower, the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2007 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner prescribed in this Ruling.

59. 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 95 in the Explanations part of this Ruling, below).

60. 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.

61. 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

62. Consideration of whether the sub-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?

63. A horticultural and afforestation scheme of this type can constitute the carrying on of a business. Where there is a business, or a future business, the gross proceeds from the sale of produce 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.

64. Generally, an investor will be carrying on a business of horticulture or afforestation where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the produce;

- the 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.

65. For this Project, Growers have rights, under the Sub-Lease Agreement, 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 Manager to provide services such as planting, replanting, irrigating and otherwise caring for the trees as and when required according to good horticultural and silvicultural practice. Growers are considered to control their investment. The specific cost of these services provided in the Initial Period will total \$3,850.

66. The Sub-Lease Agreement and the Management Agreement gives Growers an identifiable interest in specific trees and a legal interest in sub-leased land. Growers have the right to personally market and sell the produce and timber attributed to their Woodlots, or they may appoint the Manager to arrange the marketing and sale of the produce and timber for them. Growers will have a continuing interest in the trees.

67. Growers have the right to use the land in question for horticultural and afforestation purposes and to have the Manager come onto the land to carry out its obligations under the Constitution and the Management Agreement. The Growers' degree of control over the Manager, 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 the Manager's activities. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect. The activities described in the Sub-Lease and Management Agreements are carried out on the Growers' behalf.

68. 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 provided with the Product Ruling Application 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.

69. 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

horticultural and silvicultural practices and are of the type ordinarily found in horticultural and afforestation ventures that would commonly be said to be businesses.

70. Growers have a continuing interest in the trees from the time they are acquired until harvest. The horticultural and 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' horticultural and afforestation activities will constitute the carrying on of a business.

71. The fees associated with the horticultural and 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 fruit and 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 of the initial Management Fee is identifiable. 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

72. Expenditure prepaid by Growers for Planting and sub-lease 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.

73. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid Planting and sub-lease 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 subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

74. 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;
- 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.

75. The prepaid fees incurred by Growers do 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 fees over the period that the services for which the prepayment is made are performed.

76. Prepaid Planting and sub-lease 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 prepaid lease fees is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Prepayments where the eligible service period exceeds 13 months

77. 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.

78. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 83 to 85) 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.

79. 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 51 (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.

Interest deductibility

80. 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.

81. 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.

82. 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. Where a prepayment is for more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same, or effectively the same, as that shown above in paragraph 51 above.

Small business taxpayers

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

84. 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.

85. '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).

Expenditure of a capital nature

86. Any part of the expenditure of a Grower entering into a horticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the costs of irrigation and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Subdivision 387-B – irrigation expenditure

87. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three-year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

88. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at the amount of one third of the cost of the irrigation system in the income year in which the expenditure is incurred and one third for each of the next two income years.

89. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been \$20,000 or less; and

- the expenditure is incurred before the end of the 2000/2001 income year.

Subdivision 387-C - horticultural provisions

90. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture, to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

91. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the Mango trees in this Project, with an effective life of 30 years or more, that rate is 7%.

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

92. 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.

93. 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.

94. 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.

95. 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.

96. 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).

97. 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 one Woodlot during the year ended 30 June 2001 is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2007. Similarly, for a 2002 Grower who acquires the minimum investment of one Woodlot during the year ended 30 June 2002 is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2008.

98. 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.

99. 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 2006, and for 2002 Growers, until the year ended 30 June 2007.

100. 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.

101. 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 58) in the manner described in the Arrangement (see paragraphs 15 to 45), 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.

102. 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 Agro-Forester and additional evidence provided with the application by the Responsible Entity; and
- independent, objective and generally available information relating to the Mango and Sandalwood industries which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Section 82KL

103. 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

104. 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).

105. 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 49 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.

106. 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.

Examples

Example 1 – entitlement to ‘input tax credit’

107. 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).

Example 2 – prepaid expenditure and the apportionment of fees

108. Ray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee

will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and, thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Ray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Ray that the minimum subscription has been reached and the Project will go ahead. Ray's agreements are duly executed and management services start to be provided on that date.

Ray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

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

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Ray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000 and represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Ray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Ray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Ray in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Ray's total tax deduction for management fees in 2002).

Ray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

109. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years.

Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3,600 \times \frac{365}{365}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Detailed contents list

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

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Commissioner of Taxation

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Related Rulings/Determinations:
 PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 97/16; TD 93/34;
 TR 98/22
Subject references:

- carrying on a business
- commencement of business
- fee expenses

- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

PR 2001/79

Legislative references:

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 - 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 82KZMB
 - ITAA 1936 82KZMC
 - ITAA 1936 82KZMD
 - ITAA 1936 82KZMD(2)
 - ITAA 1936 82KZME
 - ITAA 1936 82KZME(1)
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 - ITAA 1936 82KZME(3)
 - ITAA 1936 82KZME(4)
 - ITAA 1936 82KZME(7)
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 - ITAA 1997 35-10(3)
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