

PR 2001/82 - Income tax: Australian Eucalypt Project 1998

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 This document has changed over time. This is a consolidated version of the ruling which was published on *13 June 2001*



Product Ruling

Income tax: Australian Eucalypt Project 1998

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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**, **Previous Rulings**, **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

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.

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 Australian Eucalypt Project 1998, or just simply as 'the Project', or the 'product'.

Tax laws

2. The tax laws dealt with in this Ruling are:
- Division 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include 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 between 16 December 1998 and the date this Ruling is withdrawn. 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 from 16 December 1998. 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, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax 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:

- Prospectus issued by Australian Eucalypts Limited dated 18 March 1998;
- **Lease and Management Agreement** between Australian Eucalypts Limited ('AEL'), WA Forest Properties Pty Ltd ('WAFP'), Trustees of Western Australia Limited ('TWAL') and the Grower;
- Trust Deed between AEL and R & I Australia Trustees Limited (now known as TWAL), dated 2 April 1992, First Supplemental Deed dated 19 March 1993 and Second Supplemental Deed dated 13 April 1994;
- **Loan Deed** between APT Finance Pty Ltd and the Borrower;
- **Loan Agreement** between National Australia Bank Ltd ('NABL'), and the Borrower;
- Bill Facility offer by NABL for the Project; and

- Letters from Davey Financial Management dated 7 September 1998 and 5 November 1998.

Note: certain information received from Davey Financial Management 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. In the prospectus dated 18 March 1998 applications are invited from people wishing to enter into the Lease and Management Agreement as part of The Australian Eucalypt Project 1998. The Applicant appoints AEL to be their Attorney for the purpose of entering into and executing the Lease and Management Agreement.

17. This arrangement is called the Australian Eucalypt Project 1998. Growers entering into the project will sublease land from WAFP in either Western Australia or South Australia, this land having been leased by WAFP with the head lease registered on the title to that land (page 6 of the Prospectus). Alternatively, the Grower will lease land in Victoria from APTL for the purpose of afforestation activities.

18. The Growers will enter into a Lease and Management Agreement with AEL to have Tasmanian Blue Gum (*eucalyptus globulus*) seedlings planted on their leased land for the purpose of eventual felling and sale in approximately eleven years. The Grower has the option of electing to collect their own felled forest produce instead of having the Manager sell it on their behalf (cl 18 of the Lease and Management Agreement).

19. The Underwriter, Davey Financial Management, has underwritten the offer of Lease and Management Agreements to the extent of 445 lots of 1.33 hectares each. Growers are to contribute \$7,750 for each Plot under the Lease and Management Agreement. Within the first 13 months of the date of execution of the Lease and Management Agreement, the Manager will arrange for each Grower's Plot to be planted with sufficient Tasmanian Blue Gum seedlings as would reasonably be expected to produce 300 cubic metres of harvestable timber per hectare, 11 years after planting.

Lease and Management Agreement

20. Under the Lease and Management Agreement, Growers enter into a lease for one or more Plots and contract with AEL to establish and maintain the Grower's Plot until the Forest equals or exceeds 300m³/ha and, in any event, not later than 11 years from the Commencement Date. Growers are not entitled to assign the Lease and Management Agreement except in certain circumstances (cl 7). Growers may elect to collect their own forest produce (cl 18) or AEL, acting as agent, will process and sell the forest produce as the Grower's agent for the maximum practicable price (cl 19). Non-Electing Growers will accept the Gross Proceeds of Sale in full satisfaction and discharge of Growers' rights in relation to the forest produce (cl 20). Growers execute a power of attorney enabling AEL to act on their behalf as required (cl 30). Certificates are issued to Growers (cl 39 of the Trust Deed).

Fees

21. The total fees payable in respect of services to be performed over the first 13 months of the Term under the Lease and Management Agreement are \$7,750 (cl 22).

22. The Independent Forester stated, at page 41 of the Prospectus, that '[T]he price of \$7,750 for each lot of 1.33 hectares which is the subject of a Lease and Management Agreement is comparable with similar projects elsewhere, and is considered competitive...'. At page 44, he says '... that the Australian Eucalypt Project should achieve its financial objective if the forestry regimes set out in this report are followed and good marketing arrangements are put in place'.

23. TWAL will hold the Application Fund in the trust for the Australian Eucalypt Project. The Application Fund will be released to AEL when TWAL is satisfied that certain specified criteria have been met (cl 34 of the Trust Deed).

24. The Manager agrees to pay all the expenses of performing its duties under the Lease and Management Agreement for the period commencing after the initial thirteen month term of the Lease and Management Agreement and ceasing on the termination date. AEL is required to lodge with TWAL cash or bank backed securities for an amount to be determined by an Independent Forester. This amount is placed into the Maintenance and Expense Fund to ensure sufficient reserve funds will be available, if needed, to meet ongoing maintenance costs (cl 10 of the Trust Deed). After the produce has been sold, the Non-Electing Growers are to pay the Lessor an amount equal to 5.5% of the Net Proceeds of Sale as rent (cl 3 of the Lease and Management Agreement) as well as pay the Manager a further 5.5% of the Net Proceeds of Sale as a services fee for the period

subsequent to the first 13 months of the Term (cl 23). These payments will provide both the Lessor and the Manager with commercial compensation for the provision of the leased land and the services over the respective periods of time.

Planting

25. During the first 13 month period AEL will be responsible for planting *eucalyptus globulus* seedlings on the Plot. From this period on AEL will maintain the trees in accordance with good silvicultural practice. The services to be provided by AEL over the term of the Project are outlined in Item 10 of the Schedule to the Agreement. When the yield in the Forest equals or exceeds 300m³/ha, or no later than 11 years from the Commencement Date, AEL will arrange for harvesting and will notify an Electing Grower when and where to collect produce and what the Grower's proportional shares of the costs of felling will be (cl 17). AEL will be responsible for arranging the processing and sale of the produce of the Non-Electing Growers. AEL will provide ongoing reports to the Growers on the progress of the plantations.

26. The Manager will pay the Gross Proceeds of Sale to TWAL after having deducted the Grower's proportional share of the Costs of Felling and the Costs of Sale. Out of these Net Proceeds of Sale are deducted amounts of 5.5% rent payable to the Lessor, 5.5% service fee to the Manager and 0.275% to TWAL. The balance of the Net Proceeds of Sale will be held in the Proceeds Fund on trust for the Growers (cl 21).

Finance

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

28. 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 other than APT Finance Pty Ltd, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

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

Section 35-55 - Commissioner's discretion

29. For a Grower who is an individual and who entered the Project on or after 16 December 1998 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2008 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

30. 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 36 in the Explanations part of this ruling, below).

31. Where, either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that

activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

32. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

Explanations

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

33. 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.

34. 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.

35. 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.

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

participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

37. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets is used on a continuing basis in carrying on the business activity in that year (section 35-45).

38. A Grower who was accepted into, and who has participated in the Project since 16 December 1998 is carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests or produce a taxation profit until the income year ended 30 June 2009. Growers who acquired more than one interest in the Project may however, pass one of the tests in an earlier income year.

39. 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.

40. 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 acquired an interest(s) in the Project on or after 16 December 1998 and prior to any withdrawal of this Product Ruling, the Commissioner has decided that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the years ended 30 June 2001 to 30 June 2008.

41. 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.

42. Information provided by the applicant states that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the Arrangement in this Product Ruling.

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

- the report of the independent forester; and
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Detailed contents list

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

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Commissioner of Taxation

13 June 2001

<i>Previous draft:</i>	- tax benefits under tax avoidance schemes
Not previously issued in draft form	- tax shelters - tax shelters project
<i>Related Rulings/Determinations:</i>	
TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TD 93/34; PR 1999/95	<i>Legislative references:</i>
Subject references:	- ITAA 1997 Div 35
- carrying on a business	- ITAA 1997 35-10
- commencement of business	- ITAA 1997 35-10(2)
- afforestation	- ITAA 1997 35-10(3)
- management fee expenses	- ITAA 1997 35-10(4)
- producing assessable income	- ITAA 1997 35-30
- product rulings	- ITAA 1997 35-35
- public rulings	- ITAA 1997 35-40
- schemes and shams	- ITAA 1997 35-45
- taxation administration	- ITAA 1997 35-55
- tax avoidance	- ITAA 1997 35-55(1)
	- ITAA 1997 35-55(1)(a)
	- ITAA 1997 35-55(1)(b)

ATO references:

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