

PR 2001/9 - Income tax: Great Southern Plantations 2001 and 2002 Projects

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 This document has changed over time. This is a consolidated version of the ruling which was published on *30 May 2001*



Product Ruling

Income tax: Great Southern Plantations 2001 and 2002 Projects

Contents	Para
What this Product Ruling is about	1
Date of effect	12
Withdrawal	14
Arrangement	15
Ruling	41
Explanations	55
Example	94
Detailed contents list	95

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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.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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 arrangements to which this Ruling relates. In this Ruling these arrangements are sometimes referred to as the Great Southern Plantations 2001 and/or 2002 Projects, or just simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 (ITAA 1997);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMB - 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. 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 these. 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 40) 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 31 January 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 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

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

- Application for Product Ruling dated 9 November 2000;
- Draft Prospectus prepared and issued by Great Southern Managers Australia Ltd ('GSMAL') for the Great Southern Plantations 2001 and 2002 Projects dated 10 October 2000;
- Supplemental Deed to Constitution of the Great Southern Blue Gum Plantations 2001 Scheme, made by GSMAL, undated;
- Draft Constitution of the Great Southern Plantations 2002 Scheme dated 1 November 2000;
- Compliance Plan for Great Southern Blue Gum Plantations 2001 adopted by GSMAL (as 'the Responsible Entity') dated 28 September 2000;
- Draft Compliance Plan for Great Southern Plantations 2002, undated;
- Proforma Lease between GSMAL (as the 'Grower') and Great Southern Land Holdings Pty Ltd (as the 'Landholder');
- **Draft Lease and Management Agreement ('LMA')** between GSMAL (as both the 'Lessor' and 'Responsible Entity') and the Grower dated 13 September 2000;
- **Draft Forest Right and Management Agreement** between GSMAL (as both the 'Grantor' and 'Responsible Entity') and the Grower, undated;
- Draft Management Services Agreement between GSMAL (as the 'Responsible Entity') and Great Southern Plantations Ltd ('GSPL') (as the 'Contractor'), undated;
- Draft Plantation Management Agreement between GSMAL (as the 'Responsible Entity') and GSPL (as the 'Contractor'), undated;
- Draft Marketing Services Agreement between GSMAL (as the 'Responsible Entity') and Great Southern Securities Pty Ltd ('GSSPL') (as the 'Contractor'), undated;
- Proforma **Loan Deed** between Great Southern Finance Pty Ltd ('GSFPL') and the Borrower;
- Proforma **Application for Term Finance** between GSFPL (as the 'Lender') and the Borrower;

- Draft Mortgage Debenture between GSMAL (as ‘the Financier’) and GSFPL (as ‘the Mortgagor’);
- Intercompany Loan Offer facility letter from GSMAL to GSFPL dated 11 May 1999; and
- Additional correspondence dated 28 February 2001, 11 May 2001, 14 May 2001, 17 May 2001 and 21 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.

Overview

17. The arrangements are called the Great Southern Plantations 2001 Project and the Great Southern Plantations 2002 Project.

Location	The South West and “Great Southern” areas of Western Australia; the “Green Triangle” area of South West Victoria and the South East of South Australia; and the Gladstone region of Queensland.
Type of business each participant is carrying on	Commercial growing of Eucalypt species for the production of short fibre hardwood woodchips for use in the paper industry.
Number of hectares to be under cultivation	This prospectus provides for 5,000 hectares to be planted, however, oversubscriptions may be accepted.
Size of each Woodlot	0.33 hectares
Number of trees per hectare	Guaranteed minimum average of 1,000 per hectare 12 months after planting
Expected production	250 cubic metres per hectare
Term of the investment	Approximately 11 years
Initial cost	\$3,300
Initial cost per hectare	\$10,000
Ongoing costs	GSMAL is to be paid 3.3% of net harvest proceeds as management fees and 2.75% of net harvest proceeds as rent/lease fees.
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance.

18. Growers applying under this prospectus join one of two projects depending on their date of application. The date of application also determines the date of execution of the Lease and Management Agreement and the period of provision of establishment services to which the initial fee relates. The two relevant projects are summarised as follows:

Application lodged	Project	Date of Execution	Fee	Provision of establishment services
On or before 16/6/2001	2001	On or before 16/6/2001	\$3,300	To be completed by 30/6/2001
Post 16/6/2001	2002	On or after 1/7/2001	\$3,300	To be completed by 30/6/2002

19. Growers participating in the arrangement on Project land in Western Australia, South Australia or Victoria will enter into a Lease

and Management Agreement between GSMAL (as both Lessor and Responsible Entity) and the Grower. Growers participating in the arrangement on Project land in Queensland will enter into a Forest Right and Management Agreement between GSMAL (as both Grantor and Responsible Entity) and the Grower on the same terms. Where this Ruling uses the terms 'Lease' and 'Lessor' it is intended to also include the respective terms 'Forest Right' and 'Grantor' in the same context.

20. The agreement gives the Grower a lease over an identifiable area of land called a Woodlot from GSMAL for approximately 11 years when the final distribution of the sale proceeds is made to the Grower or until the relevant Project is terminated. The Growers will also contract with GSMAL, under the Agreement, to have *Eucalyptus* seedlings planted on their Woodlot for the purpose of eventual felling and sale in approximately eleven years. Prior to harvest, Growers will have the right to apply to enter into a new Lease and Management Agreement with GSMAL to manage the coppice to produce a second crop from the original planting. This will be harvested when the volume of timber is appropriate.

21. Under this Prospectus, GSMAL proposes to offer 15,000 Woodlots of 0.33 hectares which will be planted with sufficient *Eucalyptus* seedlings to meet the harvest projections following execution of a Lease and Management Agreement. GSMAL has the right to accept oversubscriptions. There is no minimum amount that must be raised under the Prospectus for either Project. Most of the land for the Projects has been or will be leased by GSMAL from Great Southern Land Holdings Pty Ltd, a wholly owned subsidiary of GSMAL. The land has been or will be secured primarily by purchase.

22. Growers will execute a Power of Attorney enabling the Responsible Entity, GSMAL, to act on their behalf as required when they make an application for a Woodlot. Each Grower is provided with an ownership certificate and a copy of the plantation grid map from which their land and trees can be identified.

23. The Growers will also enter into a contract with the Responsible Entity for the lease and management of their Woodlot. The Responsible Entity will establish and cultivate the trees and be responsible for harvesting, processing and selling the timber. The Project is for a term of approximately 11 years. Growers may elect, within 6 years of the Commencement Date, to take their own Collectable Produce by giving written notice to the Responsible Entity and thereby become an Electing Grower (clause 18.1) or the Responsible Entity will sell the forest produce on behalf of the Non-Electing Growers for the maximum practicable price (clause 19.1).

Constitution

24. The relevant Constitution establishes each Project and operates as a deed binding on all of the Growers of the relevant Project and the Responsible Entity. The Constitution sets out the terms and conditions under which GSMAL agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the relevant Project. Pursuant to clause 29 of each Constitution, the Responsible Entity will keep a register of Growers. Growers may assign their interest only in certain circumstances as set out in clause 7 of the Lease and Management Agreement.

Compliance plan

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

Lease and Management Agreement

26. Growers participating in either Project are granted an interest in land by GSMAL in the form of a sub-lease or right to use their Woodlot for the purpose of conducting their afforestation business. A sub-lease will be granted through a Lease and Management Agreement to Growers whose Woodlot is located in Western Australia, South Australia or Victoria. A forest right will be granted through a Forest Right and Management Agreement to Growers whose Woodlot is located in Queensland.

27. Each Grower must pay Rent to the Lessor in an amount specified in clause 3 of the Lease and Management Agreement. Payment of Rent is deferred until the year the harvest proceeds are received.

28. Some of the conditions of the lease are that the Grower:

- will not use, or permit to be used, the Woodlot for a purpose other than that of commercial silviculture;
- will not use, or permit to be used, the Woodlot for residential, recreational or tourist purposes;
- must pay annual insurance premiums;
- shall keep the Woodlot in good and substantial repair; and

- must not install upon or remove anything from the Woodlot.

29. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement. The services to be performed are specified in the definitions of 'Establishment Services' and 'Services'. The Responsible Entity will supervise and manage all silvicultural activities on behalf of the Grower and must:

- prepare the ground for planting as necessary;
- plant sufficient seedlings per Woodlot as would reasonably be expected to produce 250 cubic metres per hectare by harvest time;
- cultivate, tend, cull, fertilise, replant, spray and otherwise care for the trees;
- keep access roads in good repair and the Woodlot free from rabbits and other vermin; and
- maintain the Woodlot according to good silvicultural and forestry practices.

Fees

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

- Establishment Services fee of \$3,300 payable on Application for the period from the Commencement Date to 30 June in the financial year in which execution of the Agreement takes place;
- At each relevant harvest, the Responsible Entity is entitled to 3.3% of the Net Proceeds of Sale of each harvest in consideration for meeting the ongoing management and maintenance expenses from completion of the Establishment Services until harvest;
- At each relevant harvest, the Responsible Entity is entitled to 2.75% of the Net Proceeds of Sale of each harvest for Rent during the term of the relevant agreement.

31. The Responsible Entity will use its best endeavours to arrange insurance of the Woodlot on behalf of the Grower to cover against fire and other usual risks.

32. Under the terms of each Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Application

Fund in the name of the Responsible Entity for each project. The application moneys will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the relevant Constitution have been met (clauses 7 and 8 of the Constitution).

Planting

33. During the period commencing upon execution of the Lease and Management Agreement to 30 June, GSMAL will be responsible for planting *Eucalyptus* seedlings on the Woodlots. After this period, GSMAL will maintain the trees in accordance with good silvicultural practice. The services to be provided by GSMAL over the term of the Projects are defined in clause 1 of the Agreement.

Harvesting

34. At all times the Grower has full right, title and interest in the Forest Produce and the right to have the forest produce sold for their benefit (clause 11.3). Unless the Grower elects to take possession of their timber, the Responsible Entity will arrange the marketing and sale of the forest produce.

35. Harvesting is to take place when the forest produce equals or exceeds 250 cubic metres per hectare or no later than 11 years from the Commencement Date unless the Responsible Entity believes that it would be in the best interests of the Growers for harvesting to be deferred and the relevant Growers resolve to do so by ordinary resolution (clause 17 of the LMA).

36. Growers will share the Gross Proceeds of Sale on a proportionate basis following the payment of felling costs, costs of sale, costs of chipping (if applicable), and any amounts due and payable by the relevant Grower (clause 21).

37. GSMAL will ensure that the Gross Proceeds of Sale of each Project are paid into the relevant Proceeds Fund trust bank account. The Growers' proportional share of the costs of felling and costs of sale, and, if applicable, the costs of chipping, will be paid from the Gross Proceeds of Sale to GSMAL, or the relevant contractor. GSMAL will receive from each of the Proceeds Funds an amount equal to 2.75% of the Net Proceeds of Sale, as rent, and another amount equal to 3.3%, as remuneration for the services provided following completion of the establishment services. The balance of the Net Proceeds of Sale will be distributed to the Non-Electing Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Grower's Proportional Share' are defined in clause 1 of the LMA.

38. If a Grower is an 'Electing Grower' (clauses 1 and 18 of the LMA), the Grower's proportional share of the costs of felling, rent

owed to the Lessor and the Responsible Entity's remuneration, are due for payment at the time of collection specified by the Responsible Entity for collection of the Grower's Collectable Produce (clause 18.1 of the LMA).

Finance

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

40. 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, other than Great Southern Finance Pty Ltd, 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

41. A Grower's share of the gross sale proceeds derived from the sale of 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.

Section 8-1

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

2001 Project

42. A Grower may claim the deductions in the following table where the Grower:

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

Fee Type	ITAA 1997 Section	30/6/2001	30/6/2002	30/6/2003
Establishment Services	8-1	\$3,300		
Interest	8-1	As incurred See note (i) below	As incurred See note (i) below	As incurred See note (i) below

Notes:

- (i) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Great Southern Finance Pty Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with Great Southern Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 76 to 86 below as those rules may be applicable if interest is prepaid.

2002 Project

43. A Grower may claim the deductions in the following table where the Grower:

- participates in the Project by 30 June 2002 to carry on the business of afforestation;

- incurs the fees shown in paragraph 30; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	30/6/2002	30/6/2003
Establishment Services	8-1	\$3,300	
Interest	8-1	As incurred See note (i) above	As incurred See note (i) above

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

44. 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 30; 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 94.

Interest deductibility

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

45. Some Growers may finance their participation in the Projects through a loan facility with Great Southern Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

46. The interest incurred for the year ended 30 June 2001 or 30 June 2002, for the 2001 Project and 2002 Project respectively, and in subsequent years of income, will be in respect of a loan to finance the Project business operations of growing trees and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

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

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

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

49. The prepayments provisions are discussed in detail at paragraphs 76 to 86 of this Ruling. However, in broad terms, where interest is prepaid and the period to which the interest relates is wholly or partly outside the income year in which it is incurred, then any tax deduction that is allowable must be determined using the following formula:

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

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

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

Section 35-55 - Commissioner's discretion

50. For a Grower who is an individual and who enters the 2001 Project or the 2002 Project, the rule in section 35-10 may apply to the business activity comprised by their involvement in the Project. For the 2001 Project, under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2011 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 the 2002 Project, the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2012 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.

51. 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 68 in the Explanations part of this Ruling, below).

52. 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.

53. 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.

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

54. For a Grower who participates in the Project and incurs expenditure as required by the Lease and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 76 to 83);
- expenditure by the Grower does not fall within the scope of sections 82KZMB - 82KZMD (but see paragraphs 76 to 83);
- expenditure by the Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 76 to 83);
- 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.

Explanations

Section 8-1

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

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

Is the Grower carrying on a business?

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

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

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the timber;
- the afforestation activities are carried out on the investor's behalf; and

- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

58. For this Project, Growers have rights under the Lease and Management Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the same agreement Growers appoint the Responsible Entity to provide services such as planting, cultivating, tending, culling, fertilising, replanting, spraying and otherwise caring for the trees as and when required according to good silvicultural practice. Growers are considered to control their investment. The specific cost of these services provided in the initial period to 30 June of the relevant year will total \$3,300.

59. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and a legal interest in leased land. Growers have the right to personally market and sell the timber attributed to their Woodlot or they may appoint the Responsible Entity to arrange the marketing and sale of the timber for them. Growers will have a continuing interest in the trees.

60. Growers have the right to use the land in question for afforestation purposes and to have the Responsible Entity come onto the land to carry out its obligations under the Constitution and the Lease and Management Agreement. The Growers' degree of control over the Responsible Entity, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on 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 afforestation activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

61. 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.

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

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

64. The fees associated with the afforestation activities will relate to the gaining of income from the business and, hence, have a sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will, therefore, be deductible under paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component of the management fee is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

65. 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.

66. 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.

67. 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.

68. 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 Projects, they are beyond the scope of this Product Ruling and are not considered further.

69. 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).

70. A Grower who participates in the 2001 Project or the 2002 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, for the 2001 Project, a Grower who acquires the minimum investment of one Woodlot during the year ended 30 June 2001 is unlikely to pass one of the objective tests until the year ended 30 June 2012. Similarly, for the 2002 Project, a 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 until the year ended 30 June 2013.

71. 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.

72. 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 2001 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 2011, and for the 2002 Project, until the year ended 30 June 2012.

73. 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.

74. 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 50) in the manner described in the Arrangement (see paragraphs 15 to 40), 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.

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

- the report of the Independent Forester and additional evidence provided with the application by the Responsible Entity; and
- independent, objective and generally available information relating to the plantation timber industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

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

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

77. In this Project, the fee for Establishment Services of \$3,300 per Woodlot will be incurred on execution of the Lease and Management Agreement. The fee is charged for providing management services to a Grower by 30 June of the year of execution of the Agreements. In particular, the fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the fee has been inflated to result in reduced fees being payable for subsequent years.

78. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Responsible Entity doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 30, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

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

79. Although not required under either the Management Agreement or the Lease Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 78 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

80. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Lease Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means, generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Growers is a 'small business taxpayer'.

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

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

82. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if

the Grower is a ‘small business taxpayer’ or section 82KZMD if the Grower is not a ‘small business taxpayer’. For a ‘small business taxpayer’ (see paragraphs 87 to 89) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 81 above, concerning section 82KZMF.

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

Interest deductibility

84. 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.

85. 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 section 82KZME, ‘agreement’ (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project that is not described in the Arrangement or otherwise dealt with in the Product Ruling.

86. 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 determine any tax deduction using the formula in subsection 82KZMF(1) as shown above at paragraph 81.

Small business taxpayers

87. 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'.

88. 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.

89. '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).

Section 82KL

90. 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

91. 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).

92. 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 42 to 43 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.

93. 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’

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

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

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

Detailed contents list

95. 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	12
Withdrawal	14
Arrangement	15
Overview	17
Constitution	24
Compliance plan	25

Lease and Management Agreement	26
Fees	30
Planting	33
Harvesting	34
Finance	39
Ruling	41
Assessable income	41
Section 8-1	42
Deductions where a Grower is not registered nor required to be registered for GST	42
<i>2001 Project</i>	42
<i>2002 Project</i>	43
Deductions where a Grower is registered or required to be registered for GST	44
Interest deductibility	45
(i) <i>Growers who use Great Southern Finance Pty Ltd as the finance provider</i>	45
(ii) <i>Growers who DO NOT use Great Southern Finance Pty Ltd as the finance provider</i>	47
Division 35 - deferral of losses from non-commercial business activities	50
Section 35-55 - Commissioner's discretion	50
Sections 82KZM, 82KZMB - 82KZMD, 82KZME - 82KZMF, 82KL and Part IVA	54
Explanations	55
Section 8-1	55
Is the Grower carrying on a business?	56
Division 35 – deferral of losses from non-commercial business activities	65
Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF	76
<i>Growers who choose to pay fees for a period in excess of that required by the Project's agreements</i>	79
Interest deductibility	84
Small business taxpayers	87
Section 82KL	90

Part IVA	91
Example	94
Example 1 - entitlement to an 'input tax credit'	94
Detailed contents list	95

Commissioner of Taxation
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Previous draft:

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- ITAA 1936 82KZME

- ITAA 1936 82KZME(4)

- ITAA 1936 82KZME(7)

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TD 93/34;
TR 98/22

- ITAA 1936 82KZMF

- ITAA 1936 82KZMF(1)

- ITAA 1936 Pt IVA

- ITAA 1936 177A

- ITAA 1936 177C

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- ITAA 1997 35-40

- ITAA 1997 35-45

- ITAA 1997 35-55

- ITAA 1997 35-55(1)

- ITAA 1997 35-55(1)(a)

- ITAA 1997 35-55(1)(b)

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- ITAA 1997 960-335

- ITAA 1997 960-340

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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

Legislative references:

- ITAA 1936 82KL

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- ITAA 1936 82KZL(1)

- ITAA 1936 82KZM

- ITAA 1936 82KZM(1)

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- ITAA 1936 82KZMA(4)

- ITAA 1936 82KZMB

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- ITAA 1936 82KZMD(2)

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