

PR 2002/100 - Income tax: Forestry Plantation Investments Project No. 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 June 2002*



Product Ruling

Income tax: Forestry Plantation Investments

Project No. 2

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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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

Terms of Use of this Product Ruling

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

Potential participants 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 laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Forestry Plantation Investments Project No 2, or 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);
 - Division 328 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZL (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936);
 - section 82KZMG (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating 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 the tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

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. Also, the class of persons will not include any Growers that do not pay the full amount of Establishment Fees payable under the Management Agreement within 60 days of the execution of the Management Agreement.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling

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has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 26 June 2002, 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).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, 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 2005. 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 arrangement specified below. 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 person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling, dated 22 March 2002;

- **Draft Information Memorandum for Forestry Plantation Investments Project No 2 prepared by Sylvatech Ltd, received 13 June 2002;**
- **Management Agreement between Sylvatech Australia Pty Ltd ('the Manager'), Sylvatech Ltd ('Sylvatech') and the Grower, received 18 June 2002;**
- **Agreement to Sub-Lease between the Grower, Sylvatech Ltd ('Sylvatech') and the Land Owner, received 28 May 2002;**
- **Annexure 1 of the Agreement to Sub-Lease, received 28 May 2002;**
- Independent Foresters Report, prepared for Sylvatech Limited, dated 12 June 2002;
- Memorandum of Lease ('Head Lease') between the Landowner and Sylvatech Ltd (formerly Australian Plantation Group Limited), dated 16 September 1999;
- Correspondence received from the applicant or the applicant's representative dated 7 December 2001, 11 December 2001 and 19 December 2001; and
- Additional correspondence received from the applicant or the applicant's representative dated 25 March 2002, 27 March 2002, 28 May 2002, 4 June 2002, 13 June 2002, 14 June 2002 and 18 June 2002.

Note: certain information received from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

15. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

17. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

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- the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*, or
- not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001*.

18. Each of these categories is explained in paragraphs 65 to 72 in the Explanations area of this Product Ruling.

Overview

19. The arrangement is called the Forestry Plantation Investments Project No 2.

Location	Melville Island, one of the Tiwi Islands in the Arafura Sea, 60 km north of Darwin in the Northern Territory, Australia.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Acacia mangium</i> trees for the purpose of producing woodchip or other suitable timber products.
Number of hectares offered for cultivation	1,500 hectares offered under this Information Memorandum, with provisions for oversubscription.
Size of the leased area	Minimum of 10 hectares.
Minimum Allocation	10 hectares, which can be increased in increments of 1 hectare.
Number of trees planted per hectare	Approximately 1,100.
Expected production	280 m ³ /hectare.
The term of the project	6 - 9 years.
Initial cost	Minimum of \$49,500.
Initial cost per hectare	\$4,950
Ongoing costs per leased area	Annual Management Fees (deferred). Rent (deferred). Annual insurance premiums. Cost of harvesting and selling Plantation Produce. Harvest and Management Fee on the sale of Plantation Produce. Manager's Performance Fee.

20. The Project is to carry out a planting of *Acacia mangium* trees on land that is held by Sylvatech. The project is for a period of 9 years.

21. The Landowner has leased the land on the Tiwi Islands in the Northern Territory, Australia to Sylvatech and has consented to the granting of subleases to Growers to enable the Growers to undertake the Project.

22. A Sub-Lease Agreement will be entered into between Sylvatech, the Grower and the Landowner. The Sub-Lease Agreement provides for the sublease of a property located on Melville Island, which is situated 60 kilometres north of Darwin, in the Northern Territory of Australia. The property is situated at part of NT Portions 1640,1644 and 3042 from plans CP 004186m CP 004194 and CP 004186.

23. Under the Information Memorandum, Sylvatech proposes to offer a maximum of 150 Plantations. Sylvatech will accept oversubscriptions depending on the availability of land. There is no minimum subscription for the Project. Each individual Plantation will be a minimum allotment of 10 hectares of land, which can be increased in increments of 1 hectare. The Grower's Plantation will be planted with a minimum of 1,100 trees per hectare. Plantations are allocated by Sylvatech who shall maintain an up to date register of Growers, identifying the Plantation held by Growers. Applications will be accepted until 31 March 2003.

24. The Sub-Lease Agreement gives a Grower a sublease from Sylvatech over an identifiable area of land called a Plantation. The term of the Sub-Lease agreement is until the completion of the Project or on 30 June 2012, which ever happens first.

25. The Management Agreement will be entered into between Sylvatech Australia Pty Ltd (as the Manager), Sylvatech Ltd and the Grower. The Grower appoints Sylvatech Australia Pty Ltd as the manager of the Grower's commercial afforestation project that is to be conducted on the Grower's Plantation.

Memorandum of Lease

26. The Memorandum of Lease has been entered into between the Landowner and Sylvatech. Under the Agreement the Landowner grants a Lease to Sylvatech. The term of the Lease is 30 years, with the term of the lease commencing on 1 January 2000. The Lease allows Sylvatech to enter into Agreements to sub-let up to 2,500 hectares of land with the consent of the Landowner.

Agreement to Sub-Lease

27. The Sub-Lease Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between Sylvatech Ltd as the Sub-Lessor, the Grower and the Landowner. Under the terms of Agreement the Grower may only use the Land for the purposes of tree farming.

28. The Agreement commences on the date the Sub-Lease Agreement is executed. The Agreement is terminated pursuant to the provisions of the Agreement or on the date of completion of the Sub-Lease of the Land (clause 1 of Annexure 1). Should the Head Lease terminate for any reason the Sublease will continue as a Lease between the Grower and the Landowner (clause 6.2 of Annexure 1).

29. Growers participating in the Project are granted an interest in the Land by Sylvatech in the form of a lease to use their Plantation for the purpose of conducting a long term business of undertaking the establishment and management of an *Acacia mangium* plantation. All trees, wood and other produce from the Plantation will be the property and right of the Grower.

30. Under the terms of the Sub-Lease, among other things, the Grower must:

- comply with the covenants, terms and conditions of the Head Lease (other than any payment obligations of Sylvatech) as if the Grower was the Lessee under the Head Lease;
- not use or permit any other person to use the area for any purpose other than that of a commercial forestry plantation for chipping and exporting woodchips or any other purposes permitted by the Head Lease;
- conduct their operations in an orderly and respectable manner and according to the best forestry practice; and
- conduct their operations in a culturally sensitive manner at all times.

31. In return, the Grower has the right to conduct a commercial forestry project on the Plantation and peaceably possess and enjoy the Plantation during the term of the Agreement.

Management Agreement

32. The Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between the Manager, Sylvatech and the Grower. Under the Agreement the Grower appoints the Manager to establish, maintain and manage the Grower's Plantation and be responsible for the

harvesting, processing and sale of the Plantation Produce from the Grower's Plantation. The Manager will sell the Plantation Produce on behalf of the Growers for the highest practicable price (clause 9.3).

33. The Agreement commences on the date of execution of the Management Agreement.

34. The Management Agreement provides that each Grower appoints the Manager to perform services under the agreement. The services to be performed are specified in clauses 8 and 9 of the Agreement. The Manager will supervise and manage all forestry services to be carried out on the Plantation on behalf of the Grower including, but not limited to, the provision of the following services:

- (i) Establishment Services, including Initial Maintenance Services, being:
 - ploughing, ripping and mounding the Plantation;
 - spraying the Plantation for the control of weeds which significantly interfere with the growth or the trees;
 - supplying and allocating to the Grower sufficient seedlings or cuttings of *Acacia mangium* into planting pots or nursery beds, and growing and caring for such plants, to enable the Manager to plant not less than 1,100 plants per hectare on the Plantation;
 - planting on the Plantation with not less than 1,100 trees per hectare;
 - supplying and applying fertiliser to the trees on the Plantation to the extent that is determined necessary by the Manager;
 - replant any significant areas where early deaths will limit the growth of the plantation;
 - monitor and control weed growth, during the first wet season post planting that may limit the growth of the plantation; and
 - monitor the development of the tree and, if economically feasible, conduct form pruning operations to reduce the incidence of multiple stemmed trees.
- (ii) Management Services, being:
 - tend and otherwise care for the Trees as and when required;

- monitor survival over the first dry season and replant any significant areas where early deaths will limit the growth of the plantation;
- monitor the development of tree form and, if economically feasible, conduct form pruning operations to reduce the incidence of multiple stemmed trees;
- monitor and control, to the extent necessary, any insects or vermin that may be causing significant damage to the trees;
- monitor soil and foliar nutrient status and, to the extent determined necessary by the Manager, fertilise the trees;
- maintain in good repair and condition access to the Plantation;
- use all reasonable measures by fumigating and poisoning and spraying for controlling the Plantation from vermin and or noxious weeds; and
- maintain in good repair and condition adequate firebreaks and waterpoints in and about the Plantation.

35. The Manager will plant the Trees during the wet season of the year ended 30 June 2003, following the execution of the Sub-Lease Agreement and the Management Agreement.

Plantation Establishment

36. For the Growers whose Management Agreements are executed on or before 30 June 2002 (**referred to in this Ruling as 2002 Growers**) all Establishment Services, that relate to the establishment of the Grower's Plantation, for which the Establishment Fee is payable are to be completed within 12 months of the date of Commencement of the Management Agreement. As part of the Establishment Services, following the establishment of the Plantation, the Manager must carry out the Initial Maintenance Services in consideration for the payment of the Establishment Fee. For 2002 Growers the Initial Maintenance Services are to be carried out from the date of completion of the establishment of the Plantation and by 30 June 2003. For the Growers whose Management Agreements are executed during the period on or after 1 July 2002 and on or before 31 March 2003 (**referred to in this Ruling as 2003 Growers**) all Establishment Services, including Initial Maintenance Services, for

which the Establishment Fee is payable are to be completed by 30 June 2003. Sylvatech will not accept any application for Plantations after 31 March 2003.

Harvesting

37. For the term of the agreement, the Grower will have full right, title and interest in the Plantation Produce from the Grower's Plantation and the right to have the Plantation Produce from the Grower's Plantation sold for their benefit (clause 6). Unless the Grower takes possession of their Plantation Produce as a result of default by the Manager pursuant to the provisions of the Management Agreement, the Manager will arrange the harvesting, processing, marketing and sale of the Plantation Produce.

38. The Manager will harvest the Plantation Produce at a time that it estimates that the best return will be obtained for the Grower. Harvesting will not commence earlier than 6 years after the Commencement Date and no later than 31 December 2011. Under the Agreement harvesting may occur over a number of years. Where the Manager determines the best return will be obtained for the Grower if the Trees are sold on the stump rather than as cut logs or woodchips, the Manager will arrange for the sale of the trees on the stump.

39. Growers will share in the gross sale proceeds on a proportionate basis following the payment of any fees and expenses payable pursuant to the Management Agreement and, where applicable, the Manager's Performance Fee (clauses 9.4, 9.8 and 9.9). Under the Agreement the Manager has the discretion, where it believes that it is in the best interests of the Grower to do so, to pool the logs or woodchips produced from the Grower's Trees with those produced by other growers or licensees of Sylvatech and/or the Landowner. Where the Manager determines that the Plantation Produce from the Project is to be pooled with logs or woodchips from other forestry projects, the Manager will maintain a record of the cubic metres of Plantation Produce harvested from each Project. In this event the proceeds of the sale of the pooled logs and/or woodchips will be allocated to the Project with reference to the quantity of Plantation Produce the Project contributed to the pool (clause 9.4).

Fees

40. Under the terms of the Management Agreement, a Grower will make the following payments for each hectare contained in the Grower's Plantation:

- **Establishment Fee** of \$4,950 per hectare contained in the Grower's Plantation is payable on execution of the

Management Agreement. The Establishment Fee is consideration for the Manager agreeing to carry out the Establishment Services and following the establishment of the Plantation the Initial Maintenance Services. The Establishment Fee contains an amount of \$271.70 per hectare for the provision of Initial Maintenance Services and an amount of \$4,678.30 per hectare for Plantation Establishment;

- Deferred **Management Fee** of 13.75 % of Net Harvest Proceeds is payable to the Manager following the harvest and sale of the Plantation Produce in consideration for the Manager carrying out the Management Services. Net Harvest Proceeds are the proceeds of sale of the Plantation Produce less any goods and services tax payable on the sale of the Plantation Produce and less any cost of harvest, handling, loading, transport, processing, shipping and delivery;
- **Harvesting Fee** of 4.95% of the Net Harvest Proceeds is payable to the Manager following the harvest and sale of the Plantation Produce in consideration for the Manager carrying out the Harvesting Services. The Manager shall pay Rent of 3.85% of the Net Harvest Proceeds to the Sub-Lessor out to the Harvesting fee on behalf of the Grower;
- **Performance Fee** of 36.663% of any amount by which the actual Growers Net Revenue exceeds the Target Return of \$10,771 per hectare;
- **Insurance** cover for Trees and Plantation Produce requested by the Grower; and
- **Cost of harvesting, handling, loading, transporting, processing, shipping and delivery** of Plantation Produce.

Finance

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

42. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;

- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

43. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 March 2003 and who have executed a Management Agreement and a Sub-Lease Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

44. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to those Growers that do not pay the full amount of Establishment Fees payable under the Management Agreement within 60 days of the execution of the Management Agreement.

The Simplified Tax System ('STS') - Division 328

45. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

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- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

46. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Prepaid expenditure for Establishment Fees**Sections 82KZME and 82KZMF**

47. For a 2002 Grower an amount of \$271.70 per hectare contained in the Growers Plantation is subject to the prepayment rules in sections 82KZME and 82KZMF. This amount is a part of the Establishment Fee of \$4,950 that is not expenditure that is deductible under section 82KZMG (see below).

48. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Other than expenditure deductible under section 82KZMG, where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Notes (iii) and (vi) below).

49. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' means the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

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

50. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 99 to 104.

Prepaid expenditure for ‘seasonally dependent agronomic activities’

Section 82KZMG

51. Where certain advance expenditure, and the agreement under which that expenditure is incurred, meets the requirements of section 82KZMG, the formula in subsection 82KZMF(1) will not operate to determine the timing of the deduction allowable. The requirements of section 82KZMG are set out below in paragraphs 105 to 109.

52. Among other things, expenditure that complies with section 82KZMG must be for ‘seasonally dependent agronomic activities’ that are carried out by the manager during the Project’s ‘establishment period’. The ‘eligible service period’ relating to this expenditure must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year.

Under the Management Agreement, for each hectare contained in a Grower’s Plantation, a 2002 Grower incurs \$4,678.30 for ‘seasonally dependent agronomic activities’. This expenditure is deductible in the income year that the Grower incurs this amount.

Tax outcomes for Growers who are not ‘STS taxpayers’

Assessable Income

Section 6-5

53. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

54. The Grower recognises ordinary income from carrying on the business of forestry at the time that income is derived.

Deductions for Establishment Fees

Section 8-1

55. A Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses for each hectare contained in the Grower’s Plantation:

PR 2002/100**2002 Growers**

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003
Fee for Plantation Establishment 'seasonally dependent agronomic activities'	8-1	\$4,678.30 See Notes (i) & (ii) (below)	Nil
Fee for Initial Maintenance Services	8-1	Must be calculated See Notes (i) & (iii) (below)	Must be calculated See Notes (i) & (iii) (below)

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004
Fee for Plantation Establishment	8-1	\$4,678.30 - See Notes (i) & (iv) (below)	Nil
Fee for Initial Maintenance Services	8-1	\$271.70 - See Notes (i) & (iv) (below)	Nil

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. (See Example 1 at paragraph 138).
- (ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (iii) For a Grower who is a 2002 Grower, the Establishment Fee shown in paragraph 40 (in the Arrangement) above is **NOT** deductible in full in the year incurred except to the extent that this fee is for 'seasonally dependent agronomic activities' (see Note (ii)). The deduction for that part of the Establishment Fee that is not for 'seasonally dependent agronomic activities' must be determined using the formula in subsection

82KZMF(1) (see paragraph 49). The Manager will inform Growers of the number of days in the 'eligible service period' in the income year ended 30 June 2002. This figure is necessary to calculate the deduction allowable for the fees incurred in that year. (See Example 2 at paragraph 139).

- (iv) For a Grower who is a 2003 Grower, the Establishment Fee shown in the Management Agreement is deductible in full in the year that it is incurred.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and Section 328-105

56. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

57. The Grower recognises ordinary income from carrying on the business of afforestation at the time the income is received (paragraph 328-105(1)(a)).

Deductions for Establishment Fees

Section 8-1 and section 328-105

58. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses for each hectare contained in the Grower's Plantation. However, if for any reason, an amount shown in the Tables below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

PR 2002/100**2002 Growers**

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003
Fees for Plantation Establishment 'seasonally dependent agronomic activities'	8-1 & 328-105	\$4,678.30 See Notes (iv) & (v) (below)	Nil
Fee for Initial Maintenance Services	8-1 & 328-105	Must be calculated See Notes (iv) & (vi) (below)	Must be calculated See Notes (iv) & (vi) (below)

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004
Fees for Plantation Establishment	8-1 & 328-105	\$4,678.30 - See Notes (iv) & (vii) (below)	Nil
Fee for Initial Maintenance Services	8-1 & 328-105	\$2,71.70 - See Notes (iv) & (vii) (below)	Nil

Notes:

- (v) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. (See Example 1 at paragraph 138).
- (vi) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (vii) For a Grower who is a 2002 Grower, the Establishment Fee shown in paragraph 40 (in the Arrangement) above is **NOT** deductible in full in the year in which it is paid by, or on behalf of an STS taxpayer, except to the extent that this fee is for 'seasonally dependent agronomic activities' (see Note (v)). The deduction for that part of the Establishment Fee that is not for

‘seasonally dependent agronomic activities’ must be determined using the formula in subsection 82KZMF(1) (see paragraph 49). The Manager will inform Growers of the number of days in the ‘eligible service period’ in the income year ended 30 June 2002. This figure is necessary to calculate the deduction allowable for the fees incurred in that year. (See Example 2 at paragraph 139).

- (viii) Where a 2003 Grower who is an ‘STS taxpayer’, pays the Establishment Fee in the relevant income year shown in the Management Agreement, that fee is deductible in full in the year that it is paid.

Tax outcomes that apply to all Growers

Interest

59. The deductibility or otherwise 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. However all Growers who borrow funds in order to participate in the Project should read the discussion of the prepayment rules in paragraphs 95 to 121 (below) as those rules may be applicable if interest is prepaid. Subject to the ‘excluded expenditure’ exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower’s choice.

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

Section 35-55 – Commissioner’s discretion

60. For a Grower who is an individual and who enters the Project during the income year ended 30 June 2002 and during the period on or after 1 July 2002 and on or before 31 March 2003 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 2002 to 30 June 2009 for 2002 Growers and 2003 Growers 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.

61. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 125 in the Explanations part of this ruling, below);

- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

62. Where the 'exception' in subsection 35-10(4) applies, the Grower's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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.

63. The 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 commercially viable. An assessment of Project or the product from this perspective has not been made.

Section 82KL, and Part IVA

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

- 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

Corporations Act 2001

65. For this Ruling to apply, an offer for an interest in the project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in section 761G of the *Corporations Act 2001*; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the *Corporations Act 2001*.

66. Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

67. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c));
- the 'professional investor test' (paragraph 761G(7)(d)).

68. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000.

69. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

70. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

71. Alternatively, under section 1012E, a Grower may participate in the project by accepting a 'personal offer' for an interest in the

project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

72. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Is the Grower carrying on a business?

73. For the amounts set out in the Tables above to constitute allowable deductions the Grower's forestry activities as a participant in the Forestry Plantation Investments Project No 2 must amount to the carrying on of a business of primary production.

74. Where there is a business, or a future business, the gross proceeds from the sale of the Plantation Produce will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

75. For schemes such as that of the Forestry Plantation Investments Project No. 2, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929; (1984) 15 ATR 932.

76. Generally, a Grower will be carrying on a business of forestry, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the Plantation Produce from those trees;
- the forestry activities are carried out on the Grower's behalf;
- the forestry activities of the Grower are typical of those associated with a forestry business; and

- the weight and influence of general indicators point to the carrying on of a business.

77. In this Project, each Grower enters into a Management Agreement and a Sub-Lease Agreement.

78. Under the Sub-Lease Agreement each individual Grower will have rights over a specific and identifiable area of a minimum of 10 hectares of land. The Sub-Lease Agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Sub-Lease the Grower must use the land in question for the purpose of carrying out forestry activities, and for no other purpose. The Sub-Lease allows the Project Manager to come onto the land to carry out its obligations under the Management Agreement.

79. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a Plantation on the Grower's identifiable area of land during the term of the Project. The Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Plantation on the Grower's behalf.

80. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the Plantation Produce grown on the Grower's Plantation.

81. 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 Project's description for all the indicators.

82. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the Plantation Produce that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

83. The pooling of Plantation Produce from trees grown on the Grower's Plantation with the Plantation Produce of other Growers is consistent with general forestry practices. Each Grower's proportionate share of the sale proceeds of the pooled logs or chips will reflect the proportion of the trees contributed from their Plantation.

84. The Project Manager's services are also consistent with general silvicultural practices. They are of the type ordinarily found in forestry ventures that would commonly be said to be businesses. While the size of a Plantation is relatively small, it is of a size and scale to allow it to be commercially viable. (See Taxation Ruling IT 360).

85. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Plantation and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

86. The forestry 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. For the purposes of this Ruling, the Growers' forestry activities in the Forestry Plantation Investments Project No 2 will constitute the carrying on of a business.

The Simplified Tax System - Division 328

87. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

88. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of the Establishment Fee

Section 8-1

89. Consideration of whether the Establishment Fee is deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed 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.

90. The Establishment Fee associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of Plantation Produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Establishment Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Application of prepayment provisions

91. Under the Management Agreement a 2003 Grower's Establishment Fee is not for things to be done beyond 30 June in the year in which the relevant amount is incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to this fee (see paragraphs 114 to 117).

Timing of deductions

92. In the absence of any application of the prepayment provisions, the timing of deductions for the Establishment Fee will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

93. If the Grower is not an 'STS taxpayer', the Establishment Fee is deductible in the year in which it is incurred.

94. If the Grower is an 'STS taxpayer' the Establishment Fee is deductible in the income year in which it is paid, or is paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility - section 8-1

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

96. 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. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 97 to 104).

Sections 82KZL to 82KZMG

97. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. 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 will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

98. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

99. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

100. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any

assessable income attributable to the agreement for that year; and

- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

101. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

102. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

103. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

104. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or

on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Section 82KZMG

105. Under section 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

106. Subsection 82KZMG(2) requires that the expenditure is

- incurred on or after 2 October 2001 and on or before 30 June 2006; and
- the eligible service period must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year; and
- for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

107. To satisfy subsection 82KZMG(3) the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling; and
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and

either:

- there is more than one participant in the agreement in the same capacity as the taxpayer; or
- the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

108. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling.

109. Subsection 82KZMG(5) defines the 'establishment period' to commence at the time that the first seasonally dependent agronomic activity is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a

fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

2002 Growers

110. Under the Management Agreement, a 2002 Grower incurs an Establishment Fee of \$4,950 per hectare contained in the Grower's Plantation, consisting of expenditure of \$4,678.30 for 'seasonally dependent agronomic activities' and expenditure of \$271.70 for other maintenance activities.

111. The seasonally dependent agronomic activities to which the expenditure of \$4,678.30 per hectare, incurred by the Grower, will be applied by the manager during the establishment period, consist of :

- (a) ploughing, ripping and mounding the Plantation;
- (b) spraying of the Plantation for the control of weeds, which will be carried out after the Plantation has been cultivated and prior to the planting of the trees;
- (c) supplying and allocating to the Grower sufficient seedlings or cuttings of *Acacia mangium*, and growing and caring for such plants prior to planting them;
- (d) planting on the Plantation with not less than 1,100 trees per hectare; and
- (e) supplying and applying fertiliser to the trees prior to planting or concurrently with the planting of the trees.

112. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2002 for 2002 Growers for the expenditure incurred under the Management Agreement for 'seasonally dependent agronomic activities'. The balance of the expenditure incurred under the Management Agreement meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

113. That part of the prepaid Establishment Fee incurred by a 2002 Grower for Initial Maintenance Services that are not 'seasonally dependent agronomic activities' does not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for this expenditure is determined using the formula in subsection

82KZMF(1). Section 82KZMF will apportion the deduction for this part of the prepaid Establishment Fee over the period that the services for which the prepayment is made are provided, being from the date of completion of the establishment of the Plantation to 30 June 2003.

2003 Growers

114. The Management Agreement also requires that a 2003 Grower incurs an Establishment Fee of \$4,950 per hectare contained in the 2003 Grower's Plantation. The Establishment Fee consists of expenditure of \$4,678.30 for Plantation Establishment and expenditure of \$271.70 for the performance of Initial Maintenance Service, which are to be completed during the period from the date the Grower commences to participate in the Project to 30 June 2003.

115. The Establishment Fee incurred under the Management Agreement is not prepaid. This fee is charged for providing Establishment Services to a 2003 Grower until 30 June of the year in which the fee is incurred.

116. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the 2003 Grower's Establishment Fee.

117. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the relevant fee in the income year in which the fee is incurred.

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

118. A 2003 Grower is not able to choose to prepay the Establishment Fee for a period beyond the income year in which the expenditure is incurred as the Manager will only accept applications until 31 March 2003 and all Establishment Services to which the Establishment Fee relates are for things to be done by 30 June 2003, being the year in which the relevant amount is incurred.

119. Although not required under the Management Agreement with Sylvatech Australia Pty Ltd and Sylvatech Ltd, a Grower participating in the Project may choose to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers to fund their participation in the Project may either choose, or be required to prepay interest. Where this occurs section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

120. For these Growers, the amount and timing of deductions for any relevant prepaid fees or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

121. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

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

122. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

123. 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.

124. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

125. For the purposes of applying Division 35, 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.

126. In broad terms, the tests require:

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

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- (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, or an interest in real property, (excluding any private dwelling) 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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

127. 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 allocation of a ten hectare Plantation in the Project during the years ended 30 June 2002 or 30 June 2003 is unlikely to ever pass one of the tests. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in a harvest year.

128. 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.

129. 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, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

130. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of ten hectare Plantation in the Project is expected to be carrying on a business activity that will pass one of the tests, or will produce a taxation profit, in the income year ended 30 June 2010 where the Grower is a 2002 Grower or a 2003 Grower.

131. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2009 for 2002 Growers and 2003 Growers.

132. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 60), in the manner described in the Arrangement (see paragraphs 14 to 42). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

- the report of the independent forester and additional expert or scientific evidence provided with the application by the Applicant;
- 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 Applicant ;
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Section 82KL - recouped expenditure

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

Part IVA - general tax avoidance provisions

135. 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).

136. The Forestry Plantation Investments Project No 2 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the

scheme, in the form of tax deductions for the amounts detailed at paragraphs 55 and 58 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

137. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Plantation Produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing 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 GST input tax credits

138. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$1/11 \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$1/11 \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

Example 2 – Apportionment of Fees

139. Murray 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 for each Woodlot are \$5,000 in Year 1, consisting of \$4,500 for ‘seasonally dependent agronomic activities’ undertaken by the manager during the ‘establishment period’ and \$500 for other management activities. The management fee for Year 2 and 3 is \$400. 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. Murray makes an application for 3 Woodlots in the project and 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 2002 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray’s agreements are duly executed and management services start to be provided on that date.

Murray is an ‘STS taxpayer’ who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows.

First, that part of the Year 1 management fees that is for ‘seasonally dependent agronomic activities’, is deductible in full in the income year ended 30 June 2002. As Murray has 3 interests in the project this amount is (\$4,500 x 3) \$13,500.

Murray is also entitled to part of the deduction for the management fees related to other management activities (i.e., those management

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activities that are not 'seasonally dependent agronomic activities'). This amount is determined using the following formula.

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

$$\$1,500 \times \frac{26}{365}$$

= **\$107** (therefore Murray's total tax deduction in 2002 for 3 Woodlots for the Year 1 prepaid management fees of \$15,000 is \$13,607. It represents the sum of the amount paid for 'seasonally dependent agronomic activities' plus an amount for the 26 days for which the other management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$1,500 \times \frac{339}{365}$$

= **\$1,393** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

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

= **\$85** (this represents the portion of the Year 2 prepaid management fees for 3 Woodlots for the 26 days during which services were provided to Murray in the 2003 income year).

\$1,393 + \$85 = \$1,478 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

For the term of the project, Murray continues to use this method to calculate his tax deduction for the prepaid management fees for his 3 Woodlots.

Detailed contents list

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Commissioner of Taxation

26 June 2002

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Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/11;
 TR 97/16; TR 98/22; TR 2000/8;
 PR 1999/95; TD 93/34; IT 360

Subject references:

- carrying on a business
- commencement of business
- fee expenses
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- management fees expenses
- primary production
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- product rulings
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- schemes and shams
- tax administration
- tax avoidance
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