



PR 2002/104 - Income tax: The Timber Australia Project - 2002/2003 Prospectus

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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*



Income Tax: The Timber Australia Project – 2002/2003 Prospectus

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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.

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 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 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.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Timber Australia Project - 2002/2003 Prospectus, 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);
- subdivision 40-G (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.

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 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 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 as Growers 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. At the request of the applicant, this Ruling does not rule on any tax laws in new Division 328, concerning 'STS taxpayers'. 'STS taxpayers' are those who are both eligible and elect to become subject to the special rules in Division 328 to do with the Simplified Tax System.

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.

9. The class of persons to whom this Ruling applies also does not include persons who make an election to market the timber grown on their Woodlot(s).

10. As the offer is a stapled security, the right to subscribe for shares cannot be separated from the right to occupy a Woodlot. Although a Grower or an associate may subscribe for shares in the Land Owner, this Ruling does not apply to persons or entities who **only** own shares in the Land Owner company. These persons or entities are referred to as 'Shareholders'.

Qualifications

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 The Ruling will be withdrawn or modified.

12. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

13. 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).

14. 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

15. 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 persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling received 28 May 2002;
- Replacement Prospectus of the Timber Australia Project-2002/2003 Prospectus (the Prospectus) dated 28 May 2002;
- **Management Agreement between ARG Management Ltd and the Grower, being incorporated in Schedule 2 of the Constitution and in section 15 of the Prospectus;**
- **Management Agreement between ARG Management Ltd, Timber Australia Properties (as grantor of licence to occupy each Woodlot) and the Grower, incorporated in section 15 of the Prospectus;**
- Compliance Plan for Timber Australia Project executed by the directors of ARG Management Ltd dated 30 October 2000 with Ref 12/09/00;
- Custodian Agreement between the Responsible Entity and Australian Rural Group Ltd (Custodian), undated with Ref 12/09/00;
- Operational Management Agreement between the Responsible Entity and Timber Australia Pty Ltd dated 22 December 2000 with Ref 07/09/00;
- Constitution of Timber Australia Project dated 21 November 2000 with Ref 17/10/00;
- Amendment to Constitution of Timber Australia Project dated 28 January 2001;
- Constitution of Timber Australia Properties Ltd registered 3 October 2000;
- Amendments to Constitution of Timber Australia Properties Ltd dated 22 May 2002;
- Certificate of Title of property at Mallanganee in New South Wales dated 31 October 2001;
- Lease between Australian Rural Group Ltd and Timber Australia Properties Ltd as lessee dated 30 October 2001;

- Sub-Lease between Timber Australia Properties Ltd and Australian Rural Group Ltd as sub-lessor dated 30 October 2001;
- Draft First Supplementary Prospectus, undated;
- Additional correspondence received from the Applicant up to and including correspondence received on 18 June 2002.

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

17. The documents highlighted are those that Growers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised in paragraphs 19 to 52.

Simplified Tax System ('STS') and the non-application of this Ruling to 'STS taxpayers'

18. At the request of the applicant, this Ruling does not rule on any tax laws in new Division 328, concerning 'STS taxpayers'. 'STS taxpayers' are those who are both eligible and elect to become subject to the special rules in Division 328 to do with the Simplified Tax System. These taxpayers will, therefore, not be covered by this Ruling but can ask for a private ruling on how Division 328 applies to their involvement in the arrangement covered by this Ruling.

Overview

19. This arrangement is called the Timber Australia Project 2002/2003 Prospectus.

Location	The Northern Rivers Area of NSW (see below).
Type of business each participant is carrying on	Commercial growing and cultivation of eucalyptus trees for the purpose of harvesting, milling and selling timber.
Number of hectares under cultivation	1,000 hectares for the entire project.
Size of each Woodlot	1.0 hectare

Minimum Subscription	None
The term of the investment	15 years
Initial cost	\$6,050 plus \$1,000 for shares in the Land Owner which may be owned by the Grower or an associate.
Initial cost per hectare	\$6,050
Ongoing costs	Plantation Fee of \$770 in Year 1 and \$660 in each of Years 2, 3 & 4. Plantation Fees in respect of First, Second and Third Harvests. Operational Costs and Profit Share in relation to Second and Third Harvests.

20. The Timber Australia Project is a managed investment scheme. To invest in this Project applicants must subscribe for ten A Class shares in the Land Owner (Timber Australia Properties Limited), which provides the applicants with the right to carry on an afforestation business on a one hectare allotment called a Woodlot and the right to enter into a Management Agreement under which applicants direct the Responsible Entity (ARG Management Limited) to carry out afforestation activities on their Woodlot. As the offer is a stapled security, the ownership of shares cannot be separated from the right to plant and grow trees on the Woodlot in accordance with the Management Agreement. However applicants may hold the shares in the Land Owner directly, or indirectly through a related entity or an associate.

21. Applicants who enter into the Management Agreement are called Growers. Applicants who do not enter the Management Agreement and **only** own shares in the Land Owner are referred to as 'Shareholders'. This Ruling does **not** apply to applicants who do not enter into the Management Agreement and who **only** own shares in the Land Owner.

22. Growers will execute a Power of Attorney enabling the Land Owner to act on their behalf as required when they make an application for a Woodlot. Growers participating in the arrangement will hold the Woodlots by way of a licence incorporated as part of the Management Agreement (section 19). Under this arrangement Growers will hold a licence over their Woodlot until either the termination of the Grower's Interest or 30 June 2017, or the date on which all the Responsible Entity's obligations under the Agreement cease.

23. The Land Owner, Timber Australia Properties Limited owns land known as "Taylor's" which will be used as the Project Land, and which is described as being Lots 94, 96, 97 & 104 in Deposited Plan 14126 (NSW). In addition, the Land Owner has option(s) over additional land if required.

24. The Land Owner has entered into an agreement under which it leases the Project Land to the Custodian, ARG Rural Group Limited for a period of 15 years and 1 day. The Custodian then subleases the Project land back to the Land Owner to allow that company to license individual allotments to Growers.

25. Each Woodlot will be 1.0 hectare. The trees to be planted are primarily Sydney Blue Gums and Spotted Gums. The Woodlots will be separately identified on an aerial photographic map.

26. Overall, it is proposed to plant up to 1,000 hectares representing 1,000 Woodlots. However the Responsible Entity is able to accept subscriptions to the extent that suitable land is available. There is no minimum subscription for this Prospectus. Although the Prospectus does not close until 19 May 2003, the Responsible Entity has given an undertaking that no applications will be accepted where all the duties under Schedules 2 and 3 cannot be completed by 30 June 2003.

27. The Responsible Entity will be responsible for planting and growing the trees and harvesting, milling and marketing the finished timber. The Responsible Entity has engaged the Operational Manager, Timber Australia Pty Ltd to undertake these activities on its behalf. The Responsible Entity will undertake all compliance, audit, unit registry and investor accounting work..

28. At all times the Grower has full right, title and interest in the forest produce and the right to have the trees sold for his/her benefit. Growers may elect to market their own timber, such election having to be made by 30 June 2003, but such Growers, who will be referred to as Non-Electing Growers, will not be covered by this Product Ruling.

Constitution

29. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which ARG Management Ltd agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 17 of the Constitution, the Responsible Entity will keep a register of Growers. Growers may assign their interest in certain circumstances as set out in clause 16 of the Constitution.

Compliance plan

30. As required by the Corporations Law a Compliance Plan has been prepared by the Responsible Entity. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected. The Compliance Plan among other things sets out the procedures for dispute handling, the safekeeping of scheme property, keeping of accounts and records, and disaster recovery plans.

Custodian Agreement

31. The Custodian Agreement is the means by which the Responsible Entity appoints the Custodian, Australian Rural Group Ltd, to act as its custodian to hold the Scheme Property as that term is defined in section 9 of the Corporations Law. It imposes certain standards and obligations on the Custodian and the Responsible Entity, including maintaining a trust account and proper records.

32. All moneys received from applications for Woodlots shall be paid to the Custodian. The Custodian shall deposit those moneys into an Application Fund in the name of the Custodian (clause 10). Application moneys for Woodlots will be released to the Responsible Entity when the Custodian is reasonably satisfied that certain specified criteria in the Constitution have been met, including:

- (a) A Woodlot has been issued to that Grower;
- (b) The Responsible Entity is in a position to discharge its obligations under the Management Agreement;
- (c) The Land Owner has procured land for the Woodlot, noting that the subscription money for shares in the Land Owner is to be utilised to purchase the land;
- (d) The Responsible Entity and the Land Owner have attended to all matters necessary for the establishment of the Project and can attest that to the best of their knowledge (on the date of the direction to the Custodian) that there are no material breaches of the Constitution, the Compliance Plan or the Law; and
- (e) There is a lease over the Project land.

Management Agreement

33. The Management Agreement provides that each Grower appoints the Responsible Entity to perform services on the terms and

conditions set out under the agreement. In addition to the information contained in the Agreement, Schedule 1 includes the Grower's details while Schedules 2, 3 and 4 specify the services to be performed by the Responsible Entity. In accordance with the terms and conditions the Responsible Entity will establish, maintain and manage the Project on behalf of each Grower in accordance with good silvicultural practice.

34. At all times the Grower has full rights, title and interest in the forest produce and the right to have the trees sold for his/her benefit (section 4). Growers may elect to market their own timber. Such an election must be made by 30 June 2003, pursuant to clause 4.5.

35. The Responsible Entity must pay for public risk insurance out of its own funds. The Grower is at liberty to take out insurance over the Grower's Woodlot, the trees or the timber attributable to the Grower's Woodlot at the Grower's expense (section 7).

36. The conditions under which both the Grower and the Responsible Entity can terminate the Agreement are outlined in section 10.

Operational Management Agreement

37. The Operational Management Agreement is made between the Responsible Entity and Timber Australia Pty Ltd as Operational Manager. The Responsible Entity agrees to engage the Operational Manager to perform all the works required to establish the plantation on the prepared land. This includes:

- obtaining all necessary regulatory approvals to establish a plantation forestry;
- evaluating the site, selecting suitable tree species, maintaining the plantation in accordance with good silvicultural practice;
- preparation of the land including deep ripping and/or mounding;
- planting the tree seedlings on the land; and
- ensuring adequate fire, pest and disease prevention measures are in place.

38. In consideration for these services, the Responsible Entity agrees to pay fees to the Operational Manager as detailed in the Operational Management Agreement.

39. The Operational Manager also has the right to purchase from the Responsible Entity any Woodlots that come into the possession of the Responsible Entity as a consequence of the default by the Grower under the Management Agreement for \$100 per Woodlot.

Fees

40. As per section 5 of the Management Agreement, the following fees are due and payable on the dates specified for the respective period and may be paid by cheque or through the use of a credit card facility. In the Management Agreement, for participants who invest prior to or on 30 June 2002, Year 0 is defined as the period from the date of investment until 30 June 2003. Years 1 to 4 are defined as the periods of twelve months that end on 30 June in each subsequent year. For participants who invest after 30 June 2002, Year 0 is defined as the period from the date of their investment until 30 June 2003, and Years 1 to 4 are defined as the periods of twelve months that end on 30 June in each subsequent year. The fees payable per Woodlot are as follows:

- Fees payable at the time of application (Year 0):
 - (i) Services Fee of \$770 for the period from the date of the execution of the Management Agreement to the end of the financial year (Clause 4.3 and 5.1);
 - (ii) Plantation Fee of \$4,840 for establishing the Grower's Woodlot, referred to as "seasonally dependent agronomic activities". This work must be carried out within 12 months of the execution of the Management Agreement (clauses 4.3 and 5.2(a));
 - (iii) Plantation Fee of \$330 for plantation maintenance before, during and after plantation establishment (clauses 4.3 and 5.2(b));
 - (iv) Plantation Fee of \$110 for landcare operations (clauses 4.3 and 5.2(c));
- Ongoing Management:
 - (a) Plantation Fees payable for Years 1 to 4 in relation to the Responsible Entity carrying out its duties in relation to Schedule 4 for ongoing management of the Grower's Woodlot are as follows;

Plantation Fee	Year 1	\$770
	Year 2	\$660
	Year 3	\$660
	Year 4	\$660

The Plantation Fees for Years 1 to 4 must be paid prior to the commencement of each period (clause 5.3);

(b) Plantation Fee - First Harvest (Clause 5.4):

In the year of the First Harvest, which will commence approximately 6 years after the commencement of the Project the Grower must pay to the Responsible Entity the lesser of:

- (i) \$976.80 indexed from Year 0 at the intervening rate of CPI (all groups Sydney) for the period, and
- (ii) the net income attributable to the Grower's Woodlot(s) from the first harvest;

(c) Plantation Fee - Second Harvest (clause 5.6):

In the year of the Second Harvest, which will commence approximately 10 years after the commencement of the project, the Grower must pay to the Responsible Entity the amount of \$1,139.60 indexed from Year 0 at the intervening rate of CPI (all groups Sydney) for the period;

(d) Plantation Fee - Third Harvest (clause 5.8):

In the year of the Third Harvest, the Grower must pay to the Responsible Entity the amount of \$1,424.50 indexed from Year 0 at the intervening rate of CPI (all groups Sydney) for the period;

(e) Profit sharing payments to the Responsible Entity

For all Harvests following the First Harvest the Responsible Entity is entitled to the following (clause 5.9):

- (i) 10% of the net income attributable to the Grower's Woodlot in any year, being gross income less all operational costs as calculated above (without any margin being charged on such costs); plus
- (ii) 25% of the net income for that part of the net income that exceeds projections of the net income shown in the

Prospectus for the Second and Third Harvests;

- (f) Operational costs between the First Harvest and the Second Harvest, and between the Second Harvest and the Third Harvest will be met by the Responsible Entity from its own resources (clauses 5.5 and 5.7).

41. If a Grower pays any of the plantation and/or services fees referred to in paragraph 40 above by a credit card facility, then in addition to those plantation and/or services fees, the Grower must pay to the Responsible Entity a once only administration fee of \$165.

42. The Responsible Entity will arrange insurance of the harvested timber to protect against risks associated with the transport and storage of the timber attributable to the Grower's Woodlot. The Grower will be responsible for insuring the Woodlot against fire, storm, or any risk the Grower wishes to be insured against (clauses 7.1 and 7.2 of Management Agreement).

Seasonally Dependent Agronomic Activities - Plantation Fee

43. For each Woodlot, in consideration of the Responsible Entity carrying out its duties in Part A of Schedule 3 of the Management Agreement, the Responsible Entity is entitled to be paid \$4,840 for planting of each Grower's Woodlot. This payment is due on application.

44. For Growers who are accepted on or before 30 June 2002, the duties outlined in Part A of Schedule 3 of the Management Agreement pertaining to the planting and tending of trees for felling must be carried out within 12 months of signing of the Management Agreement. For Growers who are accepted after 30 June 2002, the duties outlined in Part A of Schedule 3 of the Management Agreement pertaining to the planting and tending of trees for felling must be carried out before 30 June 2003.

On-going Management

45. From Year 1, the Responsible Entity will maintain the trees in accordance with good silvicultural practice. This is outlined in Schedule 4 of the Management Agreement.

Harvesting, Milling and Sale

46. Unless Growers elect to take possession of their timber the Responsible Entity will be responsible for arranging the harvesting, milling and sale of the timber using reasonable endeavours to obtain

the maximum price available (Schedule 4 of the Management Agreement). Harvesting and milling of trees will take place about Year 6 (thinning), with a Second Harvest about Year 10 and a Final Harvest in Year 15.

47. The gross proceeds of sale of the Growers' timber will be paid direct to the Custodian who must within 7 business days either forward such amounts to the Responsible Entity for depositing into a Proceeds Fund or make a direct deposit into the Proceeds Fund (clause 6.2(a) of Compliance Plan). Within a further 7 business days, the Responsible Entity will pay to itself any fees or amounts owing to it. The balance of the net proceeds of sale will be distributed to the Growers on a proportionate basis.

Carbon credits

48. All net income from the sale of carbon credits or any benefits from the application of carbon taxes will accrue to Growers as part of this arrangement.

Shares in Timber Australia Properties Limited

49. Timber Australia Properties Limited, the Land Owner, will issue 10 Fully paid A Class shares at \$100 each to each Grower or Associate on acceptance of their application. Timber Australia Pty Ltd will also be issued fully paid B Class shares in Timber Australia Properties Limited at \$100 each. Timber Australia Pty Ltd is required to pay for these shares out of its own funds. The purchase of the shares is for the purpose of enabling Timber Australia Properties Limited to acquire suitable Project Land. A and B Class shares will rank equally.

50. The money for the 10 A Class shares in the Land Owner (\$1,000) payable by Growers as part of the application monies is an expense of a capital nature and therefore not deductible.

Finance

51. All Growers are required to fund their investment in the Project themselves or borrow from an independent lender. The Responsible Entity has indicated that an associated company, ARG Financial Group Limited, may source third party finance through the St George Bank suitable for intending participants, on normal commercial broker terms. Any such finance arrangement will be on a full recourse basis from the St George Bank. No funds from the Project will be used to provide such loans.

52. 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 ARG Financial Group Ltd as broker for the St George Bank) are involved in the provision of finance to the Grower 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

Application of this Ruling

53. This Ruling applies only to Growers who:

- are accepted to participate in the Project on or before 19 May 2003,
- have executed a Management Agreement on or before that date, and
- who do not elect to market the timber grown on his/her Woodlot(s),

where the Grower's participation in the Project does constitute the carrying on of a business of primary production. A Grower is not

eligible to claim any tax deductions until the Grower's application to enter the Project has been accepted and the Project has commenced.

Simplified Tax System ('STS') and the non-application of this Ruling to 'STS taxpayers'

54. At the request of the applicant, this Ruling does not rule on any tax laws in new Division 328, concerning 'STS taxpayers'. 'STS taxpayers' are those who are both eligible and elect to become subject to the special rules in Division 328 to do with the Simplified Tax System. These taxpayers will, therefore, not be covered by this Ruling but can ask for a private ruling on how Division 328 applies to their involvement in the arrangement covered by this Ruling.

Timing of Fees

55. In the Management Agreement, for participants who invest prior to or on 30 June 2002, Year 0 is defined as the period from the date of investment until 30 June 2003. Years 1 to 4 are defined as the periods of twelve months that end on 30 June in each subsequent year. For participants who invest after 30 June 2002, Year 0 is defined as the period from the date of their investment until 30 June 2003, and Years 1 to 4 are defined as the periods of twelve months that end on 30 June in each subsequent year.

Prepaid expenditure for Plantation Fees for Years 0 to 4

Sections 82KZME and 82KZMF

56. For Growers who are accepted on or before 30 June 2002, for each Woodlot, a Grower incurs a Plantation Fee of \$330 for Year 0, which is prepaid. This expenditure is subject to the prepayment rules in sections 82KZME and 82KZMF.

57. The annual Plantation Fees due on 30 June in the year prior to the expenditure year for Years 1 to 4 incurred by a Grower who is accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF.

58. 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 Note (iv) below).

59. 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.

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

Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 107 to 111.

Prepaid expenditure for 'seasonally dependent agronomic activities'

Section 82KZMG

60. 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.

61. The requirements of section 82KZMG are set out below in paragraphs 99 to 103.

62. 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.

63. For a Grower who is accepted either on or before 30 June 2002, or after 30 June 2002 a Grower incurs \$4,840 for 'seasonally dependent agronomic activities' for each Woodlot. 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

64. 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.

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

Deductions for Plantation Fees, Services Fee and Interest

Section 8-1

66. A Grower who is accepted into the Project and has one Woodlot and is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Grower accepted on or before 30 June 2002

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Services Fee	8-1	\$770 See Note (i) (below)		
Plantation Fee for 'seasonally dependent agronomic activities'	8-1	\$4,840 See Notes (i) & (ii) (below)		
Plantation Fee for non 'seasonally dependent agronomic activities'	8-1	\$330 See Notes (i) & (iii) (below)		
Plantation Fees for on-going management Years 1 to 4	8-1		\$770 See Notes (i) & (iv) (below)	\$660 See Notes (i) & (iv) (below)
Interest	8-1	As incurred See Note (v) (below)	As incurred See Note (v) (below)	As incurred See Note (v) (below)

Grower accepted after 30 June 2002

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Services Fee	8-1	\$770 See Note (i) (below)		
Plantation Fee for 'seasonally dependent agronomic activities'	8-1	\$4,840 See Notes (i) & (ii) (below)		
Plantation Fee for non 'seasonally dependent agronomic activities'	8-1	\$330 See Note (i) (below)		
Plantation Fees for on-going management Years 1 to 4	8-1	\$770 See Notes (i) & (iv) (below)	\$660 See Notes (i) & (iv) (below)	\$660 See Notes (i) & (iv) (below)
Interest	8-1	As incurred See Note (v) (below)	As incurred See Note (v) (below)	As incurred See Note (v) (below)

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 136.
- (ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (iii) The Services Fee which is part of the fees due on application is not for 'seasonally dependent agronomic activities' and is **NOT** deductible in full in the year in which it is incurred unless the work is completed prior to the end of the financial year in which it is incurred. Unless the work is completed prior to the end of that financial year the deduction must be determined using the formula in subsection 82KZMF(1) (see paragraph 60). In these circumstances the Project Manager will inform Growers of the number of days in the 'eligible service period' in the first year. This figure is necessary to calculate the deduction allowable for the

fees incurred in that year. (See Example 2 at paragraph 137).

- (iv) Although the Management Agreement requires the Plantation Fees to be prepaid, for a Grower who acquires the minimum allocation of one interest, the amount of those prepaid Plantation Fees is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 138). However, where a Grower acquires more than the minimum allocation in the Project, the amount of these prepaid fees may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the relevant deduction for the prepaid second and subsequent year Plantation Fees using the formula shown above in paragraph 59.
- (v) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than the St George Bank is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with the St. George Bank, should read the discussion of the prepayment rules in paragraphs 96 and 98 (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.

Deductions for capital expenditure

Subdivision 40-G

67. A Grower who is accepted into the Project and who is not an 'STS taxpayer' will also be entitled to tax deductions 'landcare operations.' The deduction shown in the following Table is determined under Subdivision 40-G.

Grower accepted on or before 30 June 2002

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Landcare operations	40-630	\$110 - see Notes (vi) & (vii) below	Nil	Nil

Grower accepted after 30 June 2002

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Landcare operations	40-630	\$110 - see Notes (vi) & (vii) below	Nil	Nil

Notes:

- (vi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example 1 at paragraph 136.
- (vii) Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

Tax outcomes that apply to all Growers**Division 35 – Deferral of losses from non-commercial business activities****Section 35-55 – Commissioner's discretion**

68. For a Non-Electing Grower who is an individual and who enters the Project during the years ended 30 June 2002 and 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 2016 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.

69. 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 123 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45.

70. 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.

71. 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 the Project or the product from this perspective has not been made.

Section 82KL and Part IVA

72. 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.

Trading Stock

73. Growing trees do not generally constitute trading stock of the Grower for the purposes of either the ITAA 1997 or the ITAA 1936. Timber comes into existence as goods at the time the trees are severed from the land and until that time the Grower has no marketable timber. A Grower who has timber on hand at the end of an income year needs to have regard to section 70-35 ITAA 1997 (section 28 of the ITAA 1936) in calculating taxable income.

Explanations

Is the Grower carrying on a business?

74. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Timber Australia Project - 2002/2003 Prospectus must amount to the carrying on of a business of primary production.

75. Where there is a business, or a future business, the gross proceeds from the sale of the logs and wood 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.

76. For schemes such as that of the Timber Australia Project - 2002/2003 Prospectus, Taxation Ruling TR 2000/8 sets out in paragraph 88 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;16 ATR 55.

77. Generally, a Grower will be carrying on a business of afforestation, 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 logs and wood produce from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

78. In this Project, each Grower enters into a Management Agreement. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a woodlot 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 woodlot on the Grower's behalf.

79. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's woodlot.

80. 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.

81. 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 logs and wood 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.

82. The pooling of wood produce from trees grown on the Grower's woodlot with the wood produce of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled wood products will reflect the proportion of the trees contributed from their woodlot.

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

84. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's woodlot 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.

85. 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. For the purposes of this Ruling, the Growers' afforestation activities in the Timber Australia Project - 2002/2003 Prospectus will constitute the carrying on of a business.

The Simplified Tax System

Division 328

86. 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.

87. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling.

Deductibility of Plantation Fees and Services Fee**Section 8-1**

88. Consideration of whether the initial plantation fees and service fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

89. The Services Fee and the Plantation Fees 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 wood 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 Plantation Fee or Services Fee except to the extent of \$110 as advised. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions**Sections 82KZL to 82KZMG**

90. 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 plantation services) 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.

91. 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

92. 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)).

93. 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.

94. 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 other than the St George Bank. 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.

95. 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.

96. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure.

97. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

98. 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

99. 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).

100. 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.

101. 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:
 - (i) there must be more than one participant in the agreement in the same capacity as the taxpayer who incurs the expenditure; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

102. 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.

103. 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

104. Under the Management Agreement, a Grower who is accepted on or before 30 June 2002 incurs \$6,050 on application consisting of expenditure of \$4,840 for 'seasonally dependent agronomic activities' and expenditure of \$1,210 for other non 'seasonally dependent agronomic activities' management services and capital expenditure. The Management Agreement also requires that a Grower incurs Plantation Fees of \$770 for Year 1 and \$660 per year during Years 2 to 4 for the performance of maintenance services during these years.

105. Expenditure for ‘seasonally dependent agronomic activities’ must be undertaken by the manager during the establishment period for the relevant planting of trees for felling. Examples of ‘seasonally dependent agronomic activities’ include:

- tending the seedlings prior to planting, and planting them;
- ripping and mounding the site where the planting is to occur;
- applying fertiliser, herbicide or pesticide in conjunction with the planting.

106. As the requirements of section 82KZMG have been met, a deduction is allowable in Year 0 for the expenditure incurred under the Management Agreement for ‘seasonally dependent agronomic activities’.

107. The Services Fee incurred by a Grower for management services that are not ‘seasonally dependent agronomic activities’ does not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for the Services Fee is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for the Services Fee over the period that the services for which the prepayment is made are provided.

108. The prepaid Year 0 Plantation Fee of \$330 (for a Grower who is accepted on or before 30 June 2002) being an amount of less than \$1,000 in the expenditure year, constitutes ‘excluded expenditure’ as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) ‘excluded expenditure’ is specifically excluded from the operation of section 82KZMF. 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.

109. However, where a Grower (who is accepted on or before 30 June 2002) acquires more than one interest in the Project and the quantum of the prepaid Year 0 Plantation Fee is \$1,000 or more, the deduction allowable for this amount will instead be subject to apportionment according to the formula in subsection 82KZMF(1).

110. The prepaid Years 1 to 4 Plantation Fees being amounts of less than \$1,000 in each expenditure year, constitute ‘excluded expenditure’ as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) ‘excluded expenditure’ is specifically excluded from the operation of section 82KZMF. A Grower who is not an ‘STS taxpayer’ can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

111. However, where a Grower acquires more than one interest in the Project and the quantum of the prepaid Year 1 to 4 Plantation Fees

are \$1,000 or more, the deduction allowable for those amounts will instead be subject to apportionment according to the formula in subsection 82KZMF(1).

Interest deductibility

Section 8-1

(i) Growers who use the St George Bank as the finance provider

112. Some Growers may finance their participation in the Project through a loan facility with the St George Bank. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of plantation fees.

113. The interest incurred for the year ended 30 June 2002 and/or in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing trees - that will continue to be 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.

114. As with the plantation fees for Years 1 to 4, in the absence of any application of the prepayment provisions (see paragraphs 91 to 98), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

115. If the Grower is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

(ii) Growers who DO NOT use the St George Bank as the finance provider

116. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with an alternative bank or financier other than the St George Bank 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.

117. 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 92 to 98).

Expenditure of a capital nature**Subdivision 40-G**

118. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to a 'landcare operation' is of a capital nature. This expenditure falls for consideration under Subdivision 40-G of the ITAA 1997.

119. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 67 (above) in the Tables and the accompanying Notes.

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

120. 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.

121. 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.

122. 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.

123. 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.

124. In broad terms, the 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, 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).

125. A Non-Electing 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 one woodlot in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2017. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

126. 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.

127. 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.

128. Information provided with this Product Ruling indicates that a Non-Electing Grower who acquires the minimum investment of one woodlot in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2017, or will produce a taxation profit, for the income years ended 30 June 2012 and 30 June 2017.

129. The Commissioner will decide for such a Non-Electing 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 2016. The taxation profit that may result from the first harvest thinnings and is projected for the second harvest do not affect the period of the Commissioner's discretion as this is considered to be 'one-off' events that are specific to the afforestation industry.

130. 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 68), in the manner described in the Arrangement (see paragraphs 16 to 52). 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 11). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

Section 82KL - recouped expenditure

132. 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

133. 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).

134. The Timber Australia Project - 2002/2003 Prospectus 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 66 and 67 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.

135. 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 wood 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 are 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 'input tax credit'**

136. 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:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4000.

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

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 *less* \$200, or \$2000.

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 \$4000 (not \$4400).

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 \$2000 only, not one tenth of \$2200).

Example 2 – Apportionment of Fees

137. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5 hectare 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.

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

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

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

= **\\$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:

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

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

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

= **\\$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.

Example 3 – Apportionment of fees where there is a contractual ‘eligible service period’ and the fees include expenditure that is ‘excluded expenditure’

138. On 1 June 2002 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and

management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his 1 hectare Woodlot and the provision of management services between the 1 July and 30 June in the following income year. On 15 June 2002 Kevin pays the Year 1 lease fee of \$400 and the Year 1 management fee of \$8,600. The Year 1 management fee is made up of \$7,500 for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' and \$1,100 for other management services.

Kevin, who is not an 'STS taxpayer' is not registered, nor required to be registered for GST.

He calculates his tax deduction for management fees and the lease fee for the **2002 income year** as follows:

Management fee

Even though he paid the \$8,600 in the 2002 income year, Kevin is only able to claim a deduction of \$7,500 for the 'seasonally dependent agronomic expenditure' in that income year. Because there are no 'days of eligible service period' in the 2002 income year, Kevin is unable to claim any part of the management fees paid to the manager for other management services, as a tax deduction in his tax return for the year ended 30 June 2002.

Lease fee

Because the \$400 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2002.

In the **2003 income year** Kevin can claim a tax deduction for that part of his first year's management fees that was not deductible in the 2002 income year. The tax deduction is calculated as follows:

$$\begin{array}{r} \$1,100 \quad \times \quad \frac{365}{365} \\ \hline \end{array}$$

= **\$1,100** (this represents the whole of that part of the first year's management fee prepaid in the 2002 income year for management services that are not 'seasonally dependent agronomic activities' undertaken by the manager in the 'establishment period'. Although this amount was incurred in the 2002 income year it is not deductible until the 2003 income year).

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

Detailed contents list

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Commissioner of Taxation

26 June 2002

<i>Previous draft:</i>	- taxation administration
Not previously issued in draft form.	- tax avoidance
	- tax benefits under tax avoidance
<i>Related Rulings/Determinations:</i>	- schemes
PR 1999/95; TR 92/1; TR 92/20;	- tax shelters
TR 97/11; TR 97/16; TR 98/22;	- tax shelters project
TR 2000/8; TD 93/34; IT 360	
<i>Subject references:</i>	<i>Legislative references:</i>
- advance deductions and expenses for certain forestry expenditure	- TAA 1953 Part IVAAA
- afforestation	- ITAA 1936 82KL
- carrying on a business	- ITAA 1936 82KZL
- commencement of business	- ITAA 1936 82KZL(1)
- fee expenses	- ITAA 1936 82KZME
- forestry agreement	- ITAA 1936 82KZME(1)
- interest expenses	- ITAA 1936 82KZME(2)
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- management fees	- ITAA 1936 82KZME(4)
- non commercial losses	- ITAA 1936 82KZME(7)
- producing assessable income	- ITAA 1936 82KZMF
- product rulings	- ITAA 1936 82KZMF(1)
- public rulings	- ITAA 1936 82KZMG
- seasonally dependent agronomic activity	- ITAA 1936 82KZMG(1)
	- ITAA 1936 82KZMG(2)
	- ITAA 1936 82KZMG(3)
	- ITAA 1936 82KZMG(4)
	- ITAA 1936 82KZMG(5)

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