



# ***PR 2002/105 - Income tax: Tumbarumba Paulownia Plantation No. 2, Prospectus No. 2***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *31 July 2002*

## Product Ruling

### Income tax: Tumbarumba Paulownia Plantation No. 2, Prospectus No. 2

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### **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 these products as investments. Further, we give no assurance that the products are commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the products. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

#### **Terms of use of this Product Ruling**

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

## What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as Tumbarumba Paulownia Plantation No. 2 Prospectus No.2, or simply as 'the Project'.

### Tax law(s)

2. The tax law(s) 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 laws 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 investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

### **Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued.

### **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 as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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## Date of effect

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11. This Ruling applies prospectively from 31 July 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 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

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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 specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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

- Application for a Product Ruling, dated 3 January 2002, received on 4 February 2002;
- Draft copy of Prospectus for the Tumbarumba Paulownia Plantation No. 2 Prospectus No.2, prepared for the Responsible Entity, Tree Owners Plantation Management Limited ('TOPML'), undated, received on 4 February 2002;
- **Draft copy of Constitution establishing the Project, dated 29 June 2000, received on 4 February 2002;**
- Copy of Supplemental Trust Deed No. 1 to the Constitution for the Tumbarumba Paulownia Plantation No. 2, dated 27 September 2000, received on 4 February 2002;
- Copy of Supplemental Trust Deed No. 2 to the Constitution for the Tumbarumba Paulownia Plantation No. 2, dated 23 May 2001, received on 4 February 2002;
- Draft Supplemental Trust Deed No.3 to the Constitution for the Tumbarumba Paulownia Plantation No. 2, dated 23 May 2002, received on 18 June 2002;
- Copy of Constitution of Responsible Entity, Tree Owners Plantation management Limited ('TOPML'), dated 25 February 1994, received on 4 February 2002;
- Draft Establishment Agreement between TOPML and the Grower, undated, received on 18 June 2002;
- **Draft Subsequent Management Agreement between TOPML and the Grower, undated, received on 18 June 2002;**
- **Draft Licence Agreement between Australian Rural Group Limited (ARG) and the Grower, undated, received on 18 June 2002;**
- Copy of Lease between the Landowner and TOPML, dated 10 February 1998, received on 4 February 2002;
- Copy of Memorandum of Variation of Lease between the Landowner and TOPML, undated, received on 4 February 2002;
- Copy of Sub-Lease between TOPML and C.J.M Nominees Ltd (CJMNL), dated 10 February 1998, received on 4 February 2002;

- Copy of Variation of Sub-Lease between TOPML and CJM Nominees Ltd (CJMNL), undated, received on 4 February 2002;
- Copy of search, dated 3/12/2002, on titles folios 1/856123 and 3/856123 from Registrar General of NSW bearing memorial that sub-lease transferred from CJM Nominees Ltd to STL Financial Services Limited, received on 4 February 2002;
- Copy of Compliance Plan for the Tumbarumba Paulownia Plantation No 2, dated 29 June 2000, received on 4 February 2002;
- Custody Agreement between TOPML and ARG, dated 24 August 2000, received on 4 February 2002;
- **Secured Loan Agreement between a Grower and PNPL, undated, received on 18 June 2002;**
- **Secured Loan Application Form, undated, received 4 February 2002;**
- Letters and attachments to ATO from the applicant's representative, dated 3 January 2002;
- Email and attachments to ATO from the applicant's representative dated 18 and 27 June 2002.

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

15. The documents highlighted are those the Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to, which 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.

**Overview**

17. The arrangement is called the Tumbarumba Paulownia Plantation No. 2, Prospectus No.2

Location	Oberne, in the South West area of New South Wales.
Type of business each participant is carrying on	Commercial growing and harvesting of Paulownia trees mainly of genus fortunei and some of genus tomentosa.
Number of hectares to be under cultivation	100 hectares.
Size of each Lot	0.25 hectares.
Trees per Lot	125
Trees per Hectare	500
The term of the investment	14 years.
Establishment Fee per Lot	\$6,050
Establishment Fee per Hectare	\$24,200
Rental fee	\$82.50 pa payable on the application, and on each anniversary
Subsequent Management Fee annually per Lot	\$467.50
Other costs	<p>TOPML is to be reimbursed for all costs, expenses and outgoings associated with the harvesting of the timber.</p> <p>TOPML will receive a fee of 15% of the Net Harvest Income.</p> <p>Optional: cost of annual insurance.</p>
Minimum investment per application	1 Lot.

**The Project**

18. Under the Prospectus, Growers are invited to develop and operate a Paulownia tree plantation on a property situated near Oberne, in the South West Slopes area of New South Wales.

19. The objective is the commercial growing, harvesting and sale of Paulownia trees.

20. The offer is for a minimum of one Lot interest per Grower, with the Application Price for each Lot being \$6,050.



21. An Applicant can be accepted into the Project in either the year ended 30 June 2003, or the year ended 30 June 2004.

22. Growers participating in the Project enter into a Licence Agreement with ARG that gives them a licence over an area of land called a 'Lot'. The initial property, known as 'Bembooka', is situated in New South Wales and is leased by the landowner to Tree Owners Plantation Management Ltd who subleases the land to ARG as the custodian for TOPML in its capacity as Responsible Entity. Additional suitable land will be secured as required also in the South West Slopes area or elsewhere in the Riverina, New South Wales after professional forestry advice on property suitability. ARG, under instruction from TOPML, grants licences to the Growers. The Growers also enter into an Establishment Agreement with TOPML to have paulownia trees mainly of the genus fortunei and some of genus tomentosa planted on the Lot. A Subsequent Management Agreement, entered into at the same time as the Establishment Agreement but commencing on the expiration of the Establishment Agreement, provides that TOPML will maintain and otherwise care for the timber on the Lot for the purpose of eventual felling, milling and sale. The period of the Project is expected to be fourteen years, although felling of timber is planned to occur in years 10, 12 and 14.

23. The total land area for the Project is anticipated to be 100 hectares and there are 400 Lots on offer, each of an area of 0.25 hectares and at a cost of \$6,050. There is no minimum subscription for the Project. Growers execute a power of attorney enabling ARG to act on their behalf as required, when they make an application for a Lot.

### **Establishment Agreement**

24. The Establishment Agreement ('the EA') is entered into between TOPML and the Grower for each Lot Under the EA, each Grower contracts with TOPML to establish the plantation in accordance with present silviculture practice, for a period of twelve months (cls 2 and 3). The works to be carried out are establishment duties as set out in cl 5. Growers are also guaranteed in the Prospectus, a minimum number of 125 growing trees per Lot after twelve months and TOPML will harvest any excess over 125 trees per Lot on its own account. This Agreement is subject to the terms of the Constitution.

### **Subsequent Management Agreement**

25. In conjunction with the EA, the Subsequent Management Agreement ('the SMA') is entered into between TOPML and the Grower for each Lot. The Lot Number(s) is identified in the Schedule

to the SMA and corresponds to the Lot Number(s) for which the Grower has a Certificate. This Agreement commences on the expiration of the Establishment Agreement, namely twelve months after signing the Establishment Agreement and reaffirms the Grower's interest in an identified parcel of land (Schedule to the SMA), for the purpose of conducting an afforestation business. The term of the Agreement extends to the time when all trees produced on the Lot have been sold, the timber is processed and sold and income distributed to Growers. This is expected to be a fourteen year period. The Agreement is subject to the terms of the Constitution.

26. Growers contract with TOPML to establish and maintain the plantation until maturity for an annual management fee (cls 2, 4 and 5). In addition, TOPML will arrange for all marketable logs produced from the Grower's Lot to be processed and sold, on the Grower's behalf (cl 8.1). The time of harvest of the timber will be at the discretion of TOPML (cl 7). Growers will share, on a proportionate basis, the balance of the Net Harvest Income after all payments and deductions have been made in accordance with clause 40.1 of the Constitution (cl 8.3).

### **Licence Agreement**

27. The Licence Agreement ('the LA') is entered into between ARG, and the Grower for each Lot. Growers are granted a contract to use the land in the form of a licence to occupy their Lot (identified in the Certificate issued to the Grower), for the purpose of conducting an afforestation business (cls 2 and 3), for an annual rent of \$82.50 per quarter hectare (cl 3, as identified in the Schedule to the LA).

### **Constitution**

28. This Constitution is issued by TOPML. As stated above, TOPML is the Responsible Entity. The Constitution sets out the terms and conditions under which TOPML agrees to act as the Responsible Entity and under which TOPML agrees to manage the Project. Separate accounts and financial records are to be maintained for the Project (cl 42.1 of the Constitution). Growers are bound by the Constitution by virtue of their participation in the Project.

29. Under the Constitution, copies of documents evidencing a Grower's interest in the Project are to be issued to the Grower after execution. The Prospectus indicates, that this documentation will include a certificate. The Lot number of a Grower is shown on the Grower's certificate. TOPML will maintain a register of Growers (cl 36.1). Growers are entitled to assign the Licence and Management Agreements in certain circumstances (cl 29.1). The Establishment Agreement, Subsequent Management Agreement and Licence

Agreement must be entered contemporaneously by Applicants signing the Application and Limited Power of Attorney Form in the Prospectus.

### **Fees**

30. In consideration of the services performed and rights granted under the terms of the Establishment, Licence and Subsequent Management Agreements, the fees payable by a Grower per Lot will be:

- Under the EA, a \$6,050 establishment fee is payable on application for the establishment services provided in the first 12 months (cl 4 of the EA);
- Under the LA, a rental fee is payable for the Licence to use the Project Land over the term of the Project (Schedule of the LA);

An amount of \$82.50 is payable in advance on application and on each anniversary of the commencement date of the EA, for services provided over the next 12 months;

- Under the SMA, a management fee is payable for plantation and maintenance services over the term of the Project (cl 4 of the SMA);

An amount of \$467.50 is payable in advance on each anniversary of the EA, for services provided over the next 12 months;

- Under the SMA, TOPML will receive a fee of 15% of the Net Harvest Income generated from the sale of each Grower's timber (cl 8.2 of the SMA);
- Under the SMA, TOPML is to be reimbursed for all costs, expenses and outgoings associated with the harvesting of the timber; and
- Under the SMA, the Grower is liable for the cost of annual insurance premiums effected by the Growers (cl 10 of the SMA).

31. The following fees are payable in the year indicated where Growers are accepted into the Project before 30 June 2002.

	<b>Year 1</b> <b>(to 30/6/03)</b>	<b>Year 2</b> <b>(to 30/6/04)</b>	<b>Year 3</b> <b>(to 30/6/05)</b>

Establishment Fee	\$6,050		
Rental Fee	\$82.50	\$82.50	\$82.50
Subsequent Management Fee	Nil	\$467.50	\$467.50

32. Under the terms of the Constitution, TOPML must deposit all monies it receives from Growers under the EA into a Trust Account established for that purpose. These monies will be released to TOPML when it is satisfied of its entitlement as manager to the monies under the terms of the EA (cl 6 of the Constitution). Likewise, all rental received under the LA and management fees received under the SMA will be paid to TOPML and deposited into the appropriate Trust Account established for that purpose (cl 13 of the Constitution).

### **Establishment and maintenance of the Plantation**

33. The management agreements set out the duties that TOPML will carry out to establish and maintain the Plantation. During the first three month period TOPML will be responsible for establishing the plantation and planting Paulownia trees on the Lot (cl 5 of the EA). On expiry of the EA, the SMA commences and takes effect over the term of the Project, whereby TOPML will be responsible for maintain the trees in accordance with good silvicultural practice (cl 6 of the SMA). Harvesting, processing and sale of timber will generally take place in years 10, 12 and 14, 14 years being the expected period of the Project (cl 7 of the SMA). TOPML will be responsible for arranging the marketing and sale of the processed timber (cl 8 of the SMA).

### **Distribution of Net Harvest Income to Growers**

34. The Constitution provides for the distribution of Net Harvest Income. All Harvest Income shall be paid to TOPML and shall be deposited into a Trust Account established by TOPML for that purpose. Within three months of payment of any amounts into the Trust Account, TOPML shall distribute the Income in accordance with clause 39.1 of the Constitution. Clauses 35(c) and 40.1 of the Constitution provide for distribution of:

- payment to TOPML as reimbursement for all costs, expenses and outgoings associated with the harvesting of the timber;
- payment of any outstanding fees owed by the Grower.

The balance remaining of Net Harvest Income is then distributed to Growers on a proportional basis (cl 39.1 of the Constitution).

## **Finance**

35. Growers can fund their investment in the Project themselves, borrow from PNPL (PNPL) or borrow from an independent lender.

36. Where a Grower borrows from PNPL, the provision of finance involves full recourse loans and the finance provider will pursue legal action against defaulting borrowers. Funds borrowed from PNPL will be forwarded to the manager, TOPML, on acceptance of the Grower into the project and directly expended on the project. No round robin arrangements are involved and TOPML will use these funds after the Grower is accepted into the project, in carrying out its obligations under the Constitution.

37. Under the financing package offered through PNPL, all Growers will make a first payment per Lot of 10% deposit of the Establishment Fee and first year Rental fee as first payment, on signing the Secured Loan Agreement. Growers may borrow for a term of 12, 24, 36 or 48 months. Growers who borrow from PNPL for a term of 12 months will repay the balance remaining after the 10% deposit over 12 interest free equal monthly instalments. Growers who borrow from PNPL over a 24, 36, or 48 month term will repay the balance remaining after the 10% deposit in equal monthly instalments at an annual interest rate of 10%.

38. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than PNPL, are involved or become involved, in the provision of finance to Growers for the Project.

## **Ruling**

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### **Application of this Ruling**

39. This Ruling applies only to Growers who are accepted to participate in the Project either:

- on or before 30 June 2003, where the Grower has executed an Establishment Agreement and a Licence Agreement on or before that date; and/or
- on or after 1 July 2003 and before the expiry of the prospectus, where the Grower has executed an Establishment Agreement and a Licence Agreement before the expiry of the prospectus.

40. 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. Acceptance into the Project is subject to payment in full by the Grower of the \$6,050 Establishment Fee per Lot and \$82.50 Rental Fee for the first 12 months per Lot.

### **The Simplified Tax System ('STS')**

#### **Division 328**

41. 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:

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

### **Qualification**

42. 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, Subsequent Management fees and Rental fees**

#### **Sections 82KZME and 82KZMF**

43. The Following expenditure incurred by a Grower who is accepted into this Project is subject to the prepayment rules in sections 82KZME and 82KZMF:

- \$19 for that part of the Establishment fee that is not expenditure that is deductible under section 82KZMG (see below);
- \$467.50 Subsequent Management Fee annually per woodlot
- \$82.50 per woodlot annual rental fee.

44. 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 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 (v) below).

45. 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.

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

46. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 90 to 95.

**Prepaid expenditure for ‘seasonally dependent agronomic activities’****Section 82KZMG**

47. 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 96 to 100.

48. 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.

49. Under the Establishment Agreement, for each Woodlot, a Grower incurs \$5,929 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**

50. 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.

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



**Deductions for Management Fees, Lease fees and Interest****Section 8-1**

52. A Grower who is not an 'STS taxpayer', who invests in the Project on or before 30 June 2003, may claim tax deductions for the following revenue expenses:

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year Ended 30 June 2003</b>	<b>Year Ended 30 June 2004</b>	<b>Year Ended 30 June 2005</b>
Fees for 'seasonally dependent agronomic activities'	8-1	\$5,929 See Notes (i) & (ii) (below)		
Other Management Fees	8-1	\$19 See Notes (i) & (iii) (below)		
Subsequent Management Fees	8-1		\$467.50 See notes (i) & (iv) (below)	\$467.50 See notes (i) & (iv) (below)
Rental fees	8-1	\$82.50 See Notes (i) & (iv) (below)	\$82.50 See Notes (i) & (iv) (below)	\$82.50 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 127.
- (ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (iii) The Establishment fee shown in the Table at paragraph 33 (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' may be determined using the formula in subsection 82KZMF(1) (see paragraph 45) unless the expenditure is 'excluded expenditure or

‘seasonally dependant agronomic activities’, in which case, an immediate deduction would be allowed.

‘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. For the purposes of this Ruling ‘excluded expenditure’ refers to an amount of expenditure of less than \$1,000 (see Example 3 at paragraph 129).

- (iv) Where a Grower who is not an ‘STS taxpayer’, pays the Subsequent Management Fees and the Rental Fees in the relevant income years shown in the Management Agreement and the Leas Agreement, those fees are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 45 unless the expenditure is ‘excluded expenditure or ‘seasonally dependant agronomic activities’, in which case, an immediate deduction would be allowed. ‘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. For the purposes of this Ruling ‘excluded expenditure’ refers to an amount of expenditure of less than \$1,000 (see Example 3 at paragraph 129).
- (v) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than PNPL is outside the scope of this Ruling. However all Growers including those who finance their participation in the Project other than with PNPL should read the discussion of the prepayment rules in paragraphs 88 to 100 (below) as those rules may be applicable if the 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.

**PR 2002/105**

53. A Grower who is not an 'STS taxpayer', who invests in the Project on or after 1 July 2003, and on or before the expiry of the prospectus, may claim tax deductions for the following revenue expenses:

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year Ended 30 June 2004</b>	<b>Year Ended 30 June 2005</b>	<b>Year Ended 30 June 2006</b>
Fees for 'seasonally dependent agronomic activities'	8-1	\$5,929 See Notes (i) & (ii) (above)		
Other Management Fees	8-1	\$19 See Notes (i) & (iii) (above)		
Subsequent Management Fees	8-1		\$467.50 See notes (i) & (iv) (above)	\$467.50 See notes (i) & (iv) (above)
Rental fees	8-1	\$82.50 See Notes (i) & (iv) (above)	\$82.50 See Notes (i) & (iv) (above)	\$82.50 See Notes (i) & (iv) (above)
Interest	8-1	As incurred See Note (v) (above)	As incurred See Note (v) (above)	As incurred See Note (v) (above)

**Deductions for capital expenditure - Division 40**

54. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation). All deductions shown in the following table are determined under Division 40 for a Grower who is accepted into the Project on or before 30 June 2003.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2003 Year 1</b>	<b>Year ended 30 June 2004 Year 2</b>	<b>Year ended 30 June 2005 Year 3</b>
Water Facilities (e.g, Irrigation)	40-515	\$34 - see Notes (vi) & (vii) below	\$34 - see Notes (vi) & (vii) below	\$34 - see Notes (vi) & (vii) below

**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 127.

- (vii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

55. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation). All deductions shown in the following table are determined under Division 40 for a Grower who is accepted into the Project on or after 1 July 2003 and on or before the expiry of the prospectus.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
Water Facilities (e.g., Irrigation)	40-515	\$34 - see Notes (vi) & (vii) above	\$34 - see Notes (vi) & (vii) above	\$34 - see Notes (vi) & (vii) above

## **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)).

**PR 2002/105****Deductions for Management fees, Lease fees, and Interest****Section 8-1 and section 328-105**

58. A Grower who is an 'STS taxpayer', who invests in the Project on or before 30 June 2003, may claim tax deductions for the following revenue expenses:

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year Ended 30 June 2003</b>	<b>Year Ended 30 June 2004</b>	<b>Year Ended 30 June 2005</b>
Fees for 'seasonally dependent agronomic activities'	8-1	\$5,929 See Notes (viii) & (ix) (below)		
Other Management Fees	8-1	\$19 See Notes (viii) and (x) (below)		
Subsequent Management Fees	8-1		\$467.50 See notes (viii) & (xi) (below)	\$467.50 See notes (viii) & (xi) (below)
Rental fees	8-1	\$82.50 See Notes (viii) & (xi) (below)	\$82.50 See Notes (viii) & (xi) (below)	\$82.50 See Notes (viii) & (xi) (below)
Interest	8-1	As incurred See Note (xii) (below)	As incurred See Note (xii) (below)	As incurred See Note (xii) (below)

**Notes:**

- (viii) 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): See example 1 at paragraph 127.
- (ix) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (x) The Establishment Fee shown in the Table at paragraph 33 (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 (ix)). The deduction for that part of the Establishment Fee that is not for 'seasonally dependent agronomic activities' may be determined using the formula in subsection 82KZMF(1) (see paragraph 45) unless the

expenditure is ‘excluded expenditure’ or ‘seasonally dependent agronomic activities’ in which case, an immediate deduction would be allowed. Excluded expenditure is an ‘exception’ to the prepayment rules and it is therefore deductible in full in the year in which it is incurred. For the purposes of this Ruling, amounts of less than \$1,000 are ‘excluded expenditure’ (see Example 3 at paragraph 129).

- (xi) Where a Grower who is an ‘STS taxpayer’, pays the Subsequent Management fees in the relevant income years shown in the Project Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees. (see paragraphs 88 to 100) In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 45, unless the expenditure is ‘excluded expenditure’. Excluded expenditure is an ‘exception’ to the prepayment rules and it is therefore deductible in full in the year in which it is incurred. For the purposes of this Ruling, amounts of less than \$1,000 are ‘excluded expenditure’ (see Example 3 at paragraph 129).
- (xii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than PNPL is outside the scope of this Ruling. However all Growers including those who finance their participation in the Project other than with Plantation Nurseries Ltd should read the discussion of the prepayment rules in paragraphs 88 to 100 (below) as those rules may be applicable if the 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.

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59. A Grower who is an 'STS taxpayer', who invests in the Project after 1 July 2003 and on or before the expiry of the prospectus, may claim tax deductions for the following revenue expenses:

Fee type	ITAA 1997 section	Year Ended 30 June 2004	Year Ended 30 June 2005	Year Ended 30 June 2006
Fees for 'seasonally dependent agronomic activities'	8-1	\$5,929 See Notes (viii) & (ix) (above)		
Other Management Fees	8-1	\$19 See Notes (viii) and (x) (above)		
Subsequent Management Fees	8-1		\$350.62 See notes (viii) & (xi) (above)	\$467.50 See notes (viii) & (xi) (above)
Rental fees	8-1	\$82.50 See Notes (viii) & (xi) (above)	\$82.50 See Notes (viii) & (xi) (above)	\$82.50 See Notes (viii) & (xi) (above)
Interest	8-1	As incurred See Note (xii) (above)	As incurred See Note (xii) (above)	As incurred See Note (xii) (above)

**Deductions for capital expenditure - subdivisions 328-D and 40-F**

60. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation). An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328.

61. The deductions shown in the following table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivision 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (xiii) and (xiv) below.

62. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the

income year in which it first uses the asset or has it ‘installed ready for use’ to produce assessable income.

63. A Grower who is an ‘STS taxpayer’), who invests in the Project on or before 30 June 2003, will be entitled to tax deductions relating to water facilities (e.g., irrigation).

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2003 Year 1</b>	<b>Year ended 30 June 2004 Year 2</b>	<b>Year ended 30 June 2005 Year 3</b>
Water facilities (e.g., irrigation)	40-515	\$102 - see Notes (xiii) & (xiv) below	Nil	Nil

**Notes:**

- (xiii) 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 127.
- (xiv) Any irrigation system, dam or bore is a ‘water facility’ as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a ‘depreciating asset’ (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower’s interest in the underlying asset is itself deemed to be a ‘depreciating asset’. If the ‘cost’ apportionable to that deemed ‘depreciating asset’ is less than \$1000, the deemed asset is treated as a ‘low-cost asset’ and that amount is deductible in full when the underlying asset is first used or ‘held’ ready for use. This is so provided the Grower is an ‘STS taxpayer’ for the income year in which it starts to ‘hold’ the asset and the income year in which it first uses the asset or has it ‘installed ready for use’ to produce assessable income. If the deemed asset is not treated as a ‘low-cost asset’, the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its ‘cost’ by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a



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‘depreciating asset’, or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Farmer on the installation of the ‘water facility’ in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

64. A Grower who is an ‘STS taxpayer’), who invests in the Project after 1 July 2003 and on or before the expiry of the prospectus, will be entitled to tax deductions relating to water facilities (e.g., irrigation).

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
Water facilities (e.g., irrigation)	40-515	\$102 - see Notes (xiii) & (xiv) above	Nil	Nil

**Tax outcomes that apply to all Growers****Interest**

65. 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 88 to 104 (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**

66. For a Grower who is an individual and who enters the Project during the year ended 30 June 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 2003 to 30 June 2011 where a

Grower is accepted into the Project in the 2002 year of income, that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling. Similarly, for a Grower who enters the Project during the year ended 30 June 2004, the Commissioner will decide for the income years ending 30 June 2004 to 30 June 2012 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

67. 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 111 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- 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)).

68. 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.

69. 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.

### **Sections 82KL and Part IVA**

70. For a Grower who participates in the Project and incurs expenditure as required by the Project 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

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### Is the Grower carrying on a business?

71. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Tumbarumba Paulownia Plantation No. 2 Prospectus No.2, must amount to the carrying on of a business of primary production.

72. Where there is a business, or a future business, the gross proceeds from the sale of the 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.

73. For schemes such as that of the Tumbarumba Paulownia Plantation No. 2 Prospectus No.2 Project, 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.

74. 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 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.

75. In this Project, each Grower enters into an Establishment Agreement, Subsequent Management Agreement and Licence Agreement. Under the Licence Agreement each individual Grower

will have rights in the form of a Licence over a specific and identifiable area of land. The Establishment Agreement and Subsequent Management Agreement provide the Grower with an ongoing interest in the specific trees on the licenced area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The licence allows the Project Manager to come onto the land to carry out its obligations under the Establishment Agreement and Subsequent Management Agreement.

76. Under the Establishment Agreement and Subsequent 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.

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

78. 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.

79. 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 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.

80. 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.

81. 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 TR 2000/8).

82. The Grower's degree of control over the Project Manager as evidenced by the Establishment Agreement and Subsequent 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.

83. 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 Tumbumba Paulownia Plantation No. 2 Prospectus No.2 Project will constitute the carrying on of a business.

## **The Simplified Tax System**

### **Division 328**

84. 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.

85. 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 Management fees and Licence fees**

### **Section 8-1**

86. Consideration of whether the Establishment fee, Subsequent Management fees, and Licence 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.

87. The Establishment fee, Subsequent Management fees, and Licence 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 fees appears to be reasonable. 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**

88. 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.

89. 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**

90. 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)).

91. 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.

92. 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 PNPL. 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.

93. 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.

94. 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.

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

95. 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**

96. 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).

97. 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.

98. 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:
  - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
  - (b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

99. 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.

100. 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**

101. Under the Establishment Agreement, a Grower incurs a Year 1 Management Fee of \$6,050 consisting of expenditure of \$5,929 for 'seasonally dependent agronomic activities' and expenditure of \$121 for other activities on acceptance into the Project

102. As the requirements of section 82KZMG have been met, a deduction is allowable in the income years ended 30 June 2003 and 30 June 2004 for the expenditure incurred under the Project Agreement for 'seasonally dependent agronomic activities'. The balance of the expenditure incurred under the Establishment Agreement in Year 1 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.

103. The \$19 non SDAA component of the initial management fees, prepaid 2003 Subsequent Management Fee of \$467.50 and the prepaid Licence fee of \$82.50 per woodlot, 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 an 'STS taxpayer' can, therefore, claim an immediate deduction for the Licence 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 each of the relevant fees in the income year in which the fee is incurred.

104. However, where a Grower acquires more than the minimum investment of one woodlot in the Project and the quantum of the prepaid Subsequent management Fees or Licence fees is \$1,000 or more, the deduction allowable for these amounts will instead be subject to apportionment according to the formula in subsection 82KZMF(1).

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

105. A Grower participating in the Project may **choose** to prepay fees /interest for a period beyond the 'expenditure year'. 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.

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

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

**Expenditure of a capital nature****Division 40 and Division 328**

108. 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 water facilities is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

109. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

110. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 54, 55, 63 and 64 (above) in the tables and the accompanying Notes.

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

111. 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;

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- 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.

112. 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.

113. 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.

114. 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.

115. In broad terms, the objective tests require:

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

116. 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 enters the Project during the year ended 30 June 2003 and who acquires the minimum allocation of 1 woodlot in the Project is unlikely to have their activity pass one of the objective tests until the income year ended 30 June 2012. Similarly a Grower who enters the project during the year ended 30 June 2004 is unlikely to pass one of these tests until the income year ended 30 June 2013. Growers who

acquire more than 1 woodlot in the Project may however, find that their activity meets one of the tests in an earlier income year.

117. 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.

118. 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, it 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.

119. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of 1 Woodlot in the Project during the financial year ended 30 June 2003 is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2012. Similarly, a Grower who enters the Project during the year ended 30 June 2004, is expected to pass one of the tests in the year ended 30 June 2013.

120. 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 year ended 30 June 2011 for a Grower accepted into the Project during the income year ended 30 June 2003. Similarly for such a Grower accepted into the Project during the income year ended 30 June 2004, this discretion will be exercised for all income years up to, and including the year ended 30 June 2012.

121. 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 66), in the manner described in the Arrangement (see paragraphs 14 to 38). 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.

122. 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 provided with the application by the Responsible Entity; and
- independent, objective, and generally available information relating to the afforestation industry.

## **Losses and Outgoings incurred under Certain Tax Avoidance Schemes**

### **Section 82KL - recouped expenditure**

123. 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.

## **Schemes to Reduce Income Tax**

### **Part IVA - general tax avoidance provisions**

124. 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).

125. The Tumbarumba Paulownia Plantation No.2 Prospectus No.2 Project, 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 52, 53, 54, 55, 58, 59, 63 and 64 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.

126. 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 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

127. 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 \$4000 (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**

128. 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 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:

$$\begin{array}{r} \$1,500 \quad \times \quad \frac{339}{365} \end{array}$$

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

$$\begin{array}{r} \$1,200 \quad \times \quad \frac{26}{365} \end{array}$$

= **\$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'**

129. 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**

31 July 2002

*Previous draft:*

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*Related Rulings/Determinations:*

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

*Subject references:*

- advance deductions and expenses for certain forestry expenditure
- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- forestry agreement
- interest expenses
- management fees
- plantation forestry
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- seasonally dependent agronomic activity
- taxation administration
- tax avoidance
- tax benefits under tax avoidance
- schemes
- tax shelters
- tax shelters project
- timber industry

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- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
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