



PR 2002/2 - Income tax: Forestry Plantation Investments Project No. 1

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 This document has changed over time. This is a consolidated version of the ruling which was published on *16 January 2002*



Product Ruling

Income tax: Forestry Plantation Investments

Project No. 1

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	47
Explanations	63
Example	128
Detailed contents list	129

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

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.

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Forestry Plantation Investments Project No 1, or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a

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

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, each of these persons, referred to as 'Growers', will have accepted an offer made under section 708 of the *Corporations Act 2001*.

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

Qualifications

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

10. 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 part 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

11. This Ruling applies prospectively from 16 January 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling Dated 18 October 2001;
- **Draft Information Memorandum for Forestry Plantation Investments Project No1 prepared by Sylvatech Ltd, dated 17 December 2001;**
- **Management Agreement between Sylvatech Australia Pty Ltd ('the Manager'), Sylvatech Ltd ('Sylvatech') and the Grower, dated 17 December 2001;**

- **Agreement to Sub-Lease Sylvatech Ltd ('Sylvatech'), the Grower and the Land Owner, dated 17 December 2001;**
- **Schedule 1 of the Agreement to Sub-Lease, dated 17 December 2001;**
- Memorandum of Lease ('Head Lease') between the Landowner and Sylvatech Ltd (formerly Australian Plantation Group Limited), dated 16 September 1999;
- Additional correspondence dated 29 November 2001, 6 December 2001, 7 December 2001, 11 December 2001 and 13 December 2001 and 19 December; and
- Communication with applicant and applicant's tax professional advisor dated 3 December 2001, 12 December 2001 and 14 December 2001.

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

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

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

17. In accordance with the above documents, a Grower who participates in the arrangement must have accepted an offer that was made under section 708 of the *Corporations Act 2001*. This Ruling does not apply unless the Grower:

- has accepted a 'personal offer' under subsections 708(1)-(7) of the *Corporations Act 2001*; or
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the *Corporations Act 2001*; or
- has accepted an offer made by a licensed dealer where the offer meets the requirements of sub-section 708(10) of the *Corporations Act 2001*;
- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the *Corporations Act 2001*; or

PR 2002/2

- is associated with Sylvatech Ltd for the purposes of subsection 708 (12).

18. Each of these categories is explained in paragraphs 63 to 71 in the Explanations area of this Product Ruling.

Overview

19. The arrangement is called the Forestry Plantation Investments Project No 1.

Location	Melville Island, one of the Tiwi Islands in the Arafura Sea, 60 km north of Darwin in the Northern Territory, Australia.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Acacia mangium</i> trees for the purpose of producing woodchip or other suitable timber products.
Number of hectares offered for cultivation	750 hectares offered under this Information Memorandum, with provisions for oversubscription.
Name used to describe the product	Tiwi Islands Acacia Project No. 1.
Size of the leased area	Minimum of 10 hectares.
Minimum Allocation	10 hectares, which can be increased in increments of 1 hectare.
Number of trees per hectare	Approximately 1,111.
Expected production	256 m ³ /hectare.
The term of the project	6 - 9 years.
Initial cost	Minimum of \$49,500.
Initial cost per hectare	\$4,950
Ongoing costs per leased area	Annual Management Fees. Rent. Annual insurance premiums. Cost of harvesting and selling Plantation Produce. Harvest and Management Fee on the sale of Plantation Produce. Manager's Performance Fee.

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

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

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

23. The Sub-Lease Agreement gives a Grower a sublease from Sylvatech over an identifiable area of land called a Plantation until the completion of the Project or on 30 June 2011, which ever happens first.

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

25. Under the Information Memorandum, the Sylvatech proposes to offer a maximum of 75 Plantations. Sylvatech will accept oversubscriptions depending on the availability of land. There is no minimum subscription for the Project. Each individual Plantation will be a minimum allotment of 10 hectares of land, which can be increased in increments of 1 hectare. The Grower's Plantation will be planted with a minimum of 1,111 trees per hectare. Plantations are allocated by Sylvatech who shall maintain an up to date register of Growers, identifying the Plantation held by Growers. Applications will be accepted until 31 March 2002.

26. Possible projected returns for Growers are outlined at pages 8 and 9 of the Draft Information Memorandum. Sylvatech does not guarantee the success of the Plantation. Growers will be exposed to the usual business risks and agricultural risks inherent in primary production due to matters beyond the control of the Manager such as adverse weather conditions, insect attacks and variable market conditions. The projected returns are subject to the inherent risks of the long-term nature of the venture. Sylvatech and the Manager have outlined these risks in the Information Memorandum.

Memorandum of Lease

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

Agreement to Sub-Lease

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

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

30. Growers participating in the Project are granted an interest in the Land by Sylvatech in the form of a lease to use their Plantation for the purpose of conducting a long term business of undertaking the establishment and management of an *Acacia mangium* plantation.

31. Each Grower must pay an annual rent to Sylvatech being an amount of \$60.50 per hectare contained in the Grower's Plantation (clause 2 of Annexure 1 of the Agreement to Sub-Lease). The Rent Fee is payable annually in advance commencing on 1 July 2002. No rent is payable from the date of commencement of the Sub-Lease Agreement to 30 June 2002. In subsequent years the Annual Rent Fees will be the amount of \$60.50 increased by the percentage increase in the CPI for Adelaide from 31 December 2001 to 30 June in the calendar year of payment.

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

- comply with the covenants, terms and conditions of the Head Lease (other than any payment obligations of Sylvatech) as if the Grower was the Lessee under the Head Lease;
- not use or permit any other person to use the area for any purpose other than that of a commercial forestry plantation for chipping and exporting woodchips or any other purposes permitted by the Head Lease;

- conduct their operations in an orderly and respectable manner and according to the best forestry practice; and
- conduct their operations in a culturally sensitive manner at all times.

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

Management Agreement

34. The Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between the Manager, Sylvatech and the Grower. Under the Agreement the Grower appoints the Manager to establish and manage the Grower's Plantation and be responsible for the harvesting, processing and sale of the Plantation Produce from the Grower's Plantation. The Manager will sell the Plantation Produce on behalf of the Growers for the highest practicable price (clause 9.3).

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

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

- Stage 1 Services being the acquisition of *Acacia Mangium* seedlings and fertilisers on the Grower's behalf;
- Stage 2 Services being cultivation, access maintenance, pre-planting weed control, planting of approximately 1,111 Trees for each hectare comprising the Grower's Plantation and fertilising the Plantation;
- do all things necessary to ensure that the Trees are planted and tended according to good farming practice and sound agricultural methods and good silvicultural practice;
- cultivating, maintaining, fertilising, spraying, pruning, thinning out and doing all other things necessary to the trees to produce mature trees;
- keep the Plantation free of vermin, weeds and other pest and complying with all laws and regulations with

respect to the keeping down and exterminating of the same;

- arrange the insurances referred to in the Management Agreement including insurance for the Trees and the Plantation Produce at the option and cost of the Grower;
- maintain in good condition and repair fire breaks for the protection of the Trees; and
- doing all other things that are necessary or incidental to the carrying out of the Growers' business to produce a viable business of growing of *Acacia Mangium* trees for woodchipping or other suitable purposes.

37. The Manager will plant the Trees during the wet season of the year ended 30 June 2002, following the execution of the Sub-Lease Agreement and the Management Agreement.

38. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Fees

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

- **Plantation Establishment Fee** of \$4,950 is payable on execution of the Management Agreement. The Plantation Establishment Fee is consideration for the Manager agreeing to carry out the establishment services contained in the Stage 1 Services and the Stage 2 Services and maintenance of the Plantation for the period to 30 June 2002. Expenditure of \$154 is contained in the Plantation Establishment Fee which will be incurred for cultivation services that form part of the Stage 2 Services;
- **Annual Management Fees** are payable annually in advance for each year of the term of the Project commencing on 1 July 2002. A Management Fee of \$82.50 is payable for the year ended 30 June 2003. In subsequent years the Annual Management Fees will be \$82.50 increased by the percentage increase in the CPI for Adelaide from 31 December 2001 to 30 June in the calendar year of payment. These Management Fees are

payable within 30 days of the provision of an invoice to the Grower.

- **Harvesting and Management Fee** of 7% of the Net Harvest Proceeds in consideration for the ongoing management of the Grower's Plantation, for the period subsequent to 30 June 2002.
- **Performance Fee** of 33.33% of any amount by which the actual Growers Net Revenue exceeds the Target Return of \$10,538 per hectare.
- **Insurance** cover for Trees and Plantation Produce requested by the Grower.
- **Cost of harvesting, chipping, transport and loading** Plantation Produce.

Plantation Establishment

40. For the Growers whose Management Agreements are executed on or before 31 March 2002 all plantation establishment services, including the Stage 1 and Stage 2 Services, for which the Plantation Establishment Fee is payable are to be completed by 30 June 2002. Sylvatech will not accept any application for Plantations after 31 March 2002.

41. Prior to the execution of Management Agreements the Manager has undertaken the cultivation services, for which the Grower has been charged \$154, that are required to be provided as part of the Stage 2 Services. The Manager will not undertake any additional work on a Plantation prior to the Plantation being allocated to a Grower.

Harvesting

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

43. The Manager will harvest the Plantation Produce at a time that it estimates that the best return will be obtained for the Grower. Harvesting will not commence earlier than 6 years after the Commencement Date and no later than 31 December 2010. Under the Agreement harvesting may occur over a number of years. Where the

Manager determines the best return will be obtained for the Grower if the Trees are sold on the stump rather than as cut logs or woodchips, the Manager will arrange for the sale of the trees on the stump.

44. Growers will share in the gross sale proceeds on a proportionate basis following the payment of any fees and expenses payable pursuant to the Management Agreement and, where applicable, the Manager's Performance Fee (clause 11.2). Under the Agreement the Manager has the discretion, where it believes that it is in the best interests of the Grower to do so, to pool the logs or woodchips produced from the Grower's Trees with those produced by other growers or licensees of Sylvatech and/or the Landowner. Where the Manager determines that the Plantation Produce from the Project is to be pooled with logs or woodchips from other forestry projects, the Manager will maintain a record of the cubic metres of Plantation Produce harvested from each Project. In this event the proceeds of the sale of the pooled logs and/or woodchips will be allocated to the Project with reference to the quantity of Plantation Produce the Project contributed to the pool (clause 9.4).

Finance

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

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

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

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

Ruling

Application of this Ruling

47. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 March 2002 and who have executed a Management Agreement and a Sub-Lease Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

48. 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.

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

49. 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

50. 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.

Tax outcomes for Growers who are not ‘STS taxpayers’**Assessable Income - section 6-5**

51. 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.

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

Deductions for Plantation Establishment fees, Management fees and Rent fees - section 8-1

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Plantation Establishment Fee	8-1	\$4,796– See Notes (i) & (ii) (below)		
Management Fee	8-1		\$82.50 – See Notes (i) & (iii) (below)	\$82.50 (indexed)– See Note (i) & (iii) (below)
Rent Fee	8-1		\$60.50 – See Notes (i) & (iii) (below)	\$60.50 (indexed)– See Notes (i) & (iii) (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 at paragraph 128;
- (ii) The Plantation Establishment Fee contains an amount of \$154 for soil cultivation. The outgoing of \$154 is expenditure of a capital nature and is not deductible under section 8-1. An amount of \$4,796 of the Plantation Establishment Fee is considered to be incurred in producing assessable income and not capital in nature. The Plantation Establishment Fee shown in

the Management Agreement is deductible to the extent of \$4,796 in the year that the fee is incurred;

- (iii) The Management fees and the Rent fees shown in the Management Agreement and the Sub-Lease Agreement 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 (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 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 104 unless the expenditure is ‘excluded expenditure’. ‘Excluded expenditure’ is an ‘exception’ to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling ‘excluded expenditure’ refers to an amount of expenditure of less than \$1,000.

Tax outcomes for Growers who are ‘STS taxpayers’

Assessable Income - section 6-5

54. 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.

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

Deductions for Plantation Establishment Fees, Management fees and Rent fees - sections 8-1 and 328-105

56. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses for each hectare contained in the Grower’s Plantation:

PR 2002/2

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Plantation Establishment Fee	8-1 & 328-105	\$4,796 - See Notes (iv), (v) and (vi) (below)		
Management Fee	8-1 & 328-105		\$82.50 – See Notes (iv), (v) & (vii) (below)	\$82.50 (indexed)– See Notes (iv), (v) & (vii) (below)
Rent Fee (Rent)	8-1 & 328-105		\$60.50 See Notes (iv), (v) & (vii) (below)	\$60.50 (indexed) – See Notes (iv), (v) & (vii) (below)

Notes:

- (iv) 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 at paragraph 128;
- (v) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid;
- (vi) The Plantation Establishment Fee contains an amount of \$154 for soil cultivation. The outgoing of \$154 is expenditure of a capital nature and is not deductible under section 8-1. An amount of \$4,796 of the Plantation Establishment Fee is considered to be incurred in producing assessable income and not capital in nature. Where a Grower who is an 'STS taxpayer', pays the Plantation Establishment Fee in the relevant income year shown in the Management Agreement, that fee is deductible to the extent of \$4,796 in the year that the fee is paid;
- (vii) Where a Grower who is an 'STS taxpayer', pays the Management fees and the Rent fees in the relevant income years shown in the Management Agreement and the Sub-Lease 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 98 to 112). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 104, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Tax outcomes that apply to all Growers

Interest

57. 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 96 to 112 (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

58. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 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 2008 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.

59. 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 116 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

60. 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.

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

Sections 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 98 to 112);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 708 of the *Corporations Act 2001*

63. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Grower under one of five categories in subsections 708(1)-(12) of the *Corporations Act 2001*. These provisions set out situations where a prospectus or similar disclosure document is not required.

64. Under subsections 708(1)-(7) a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars.

65. An offer will be a personal offer where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

66. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

67. Alternatively, a Grower who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000;
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000; or
- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:
 - (i) has net assets of at least \$2.5 million; or
 - (ii) has a gross income for each of the last 2 financial years of at least \$250,000 a year.

68. A Grower may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this

provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

69. The licensed dealer must provide a written statement of reasons for being so satisfied. Where a Grower is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

70. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. Growers who participate in the project under this provision will be, at the time the offer is made:

- a person who is a licensed or exempt dealer and who is acting as a principal;
- a person who is a licensed or exempt investment adviser and who is acting as a principal; or
- a person who controls at least \$10 million for the purposes of investment in securities.

71. Under subsection 708(12) an offer may be made to and accepted by a person who is associated with Sylvatech Ltd. Growers who participate in the project under this provision will be, at the time the offer is made, an executive officer of Sylvatech Ltd or a related body or their spouse, parent, child, brother or sister or a body corporate controlled by such a person.

Is the Grower carrying on a business?

72. For the amounts set out in the Tables above to constitute allowable deductions the Grower's forestry activities as a participant in the Forestry Plantation Investments Project No 1 must amount to the carrying on of a business of primary production.

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

74. For schemes such as that of the Forestry Plantation Investments Project No. 1, 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.

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

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

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

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

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

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

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 Plantation Produce that will return a

before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

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

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

85. The forestry activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' forestry activities in the Forestry Plantation Investments Project No 1 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. 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 rent fees - section 8-1

88. Consideration of whether the Plantation Establishment Fees, the Management Fees and Rent 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. Any part of the expenditure of a Grower entering into a forestry business 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, a portion of the management fee is paid in return for activities that the Manager has undertaken prior to the time the Grower will enter into the Management Agreement. This portion, being \$154, of the Plantation Establishment Fee is properly characterised as capital expenditure and this has been apportioned out from the amount allowed as a deduction under section 8-1.

90. The amount of \$4,796 of the Plantation Establishment Fee that is considered to be incurred in producing assessable income and not capital in nature, the ongoing Management Fees and the Rent Fees associated with the forestry activities will relate to the gaining of income from the Grower's business of forestry (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of Plantation Produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Management Fee or the Rent Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

91. Under the Management Agreement and the Sub-Lease Agreement neither plantation establishment fees, the management fees nor the rent fees are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

92. However, where a Grower **chooses** to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 98 to 112) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Timing of deductions

93. In the absence of any application of the prepayment provisions, the timing of deductions for plantation establishment fees, the management fees or the rent fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

94. If the Grower is not an 'STS taxpayer', the plantation establishment fees, the management fees and the rent fees are deductible in the year in which they are incurred.

95. If the Grower is an 'STS taxpayer' the plantation establishment fees, the management fees and the rent fees are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility - section 8-1

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

97. 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 98 to 112).

Prepayment provisions - sections 82KZL to 82KZMF

98. 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 (eg. 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.

99. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where 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 ‘STS taxpayers’ from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

100. Where 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)).

101. 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.

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

103. 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.

104. 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.

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

105. 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.

Application of the prepayment provisions to this Project

106. In this Project, an initial Plantation Establishment Fee of \$4,796 for each hectare contained in the Grower's Plantation will be incurred on execution of the Management Agreement and the Sub-Lease Agreement. The Plantation Establishment Fee is charged for providing management services a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

107. In particular, the Plantation Establishment Fee and the Management Fee are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial Plantation Establishment Fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

108. There is also no evidence that might suggest the management services covered by the fees could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial Plantation Establishment Fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Sub-Lease Agreement, rent fees are payable annually in advance for the lease of the land during the expenditure year.

109. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 31 and 39, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

110. Although not required under either the Management Agreement or the Sub-Lease Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Growers who use financiers to fund their participation in the Project may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 109 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

111. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid Rent Fees, or prepaid

interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

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

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

113. 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 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.

114. 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.

115. 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.

116. 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.

117. 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).

118. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of 10 hectares in the Project is unlikely to have their activity pass one of the tests. Growers who acquire an interest in more than 10 hectares in the Project may however, find that their activity meets one of the tests in an earlier income year.

119. 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.

120. 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:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) 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.

121. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of ten hectares in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2009. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2008. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

122. 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 58), in the manner described in the Arrangement (see paragraphs 14 to 46). 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.

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

- the report of the independent forester and additional expert or scientific evidence provided with the application by the Applicant;
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Applicant ;
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Section 82KL - recouped expenditure

124. 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

125. 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).

126. The Forestry Plantation Investments Project No 1 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 53 and 56 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.

127. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Plantation Produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

128. 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).

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	19
Memorandum of Lease	27
Agreement to Sub-Lease	28
Management Agreement	34
Fees	39
Plantation Establishment	40
Harvesting	42
Finance	45
Ruling	47
Application of this Ruling	47
The Simplified Tax System ('STS') - Division 328	49

Qualification	50
Tax outcomes for Growers who are not ‘STS taxpayers’	51
Assessable Income - section 6-5	51
Deductions for Plantation Establishment Fees, Management fees and Rent fees - section 8-1	53
Tax outcomes for Growers who are ‘STS taxpayers’	54
Assessable Income - section 6-5	54
Deductions for Plantation Establishment Fees, Management fees and Rent fees - sections 8-1 and 328-105	56
Tax outcomes that apply to all Growers	57
Interest	57
Division 35 – Deferral of losses from non-commercial business activities	58
Section 35-55 – Commissioner’s discretion	58
Sections 82KZME - 82KZMF, 82KL and Part IVA	62
Explanations	63
Section 708 of the Corporations Act 2001	63
Is the Grower carrying on a business?	72
The Simplified Tax System - Division 328	86
Deductibility of management fees, rent and insurance premiums - section 8-1	88
Possible application of prepayment provisions	91
Timing of deductions	93
Interest Deductibility - section 8-1	96
Prepayment provisions - sections 82KZL to 82KZMF	98
Sections 82KME and 82KZMF	100
Application of the prepayment provisions to this Project	106
Growers who choose to pay fees for a period in excess of that required by the Project’s agreements	110
Deferral of losses from non-commercial business activities - Division 35	113
Section 82KL – recouped expenditure	124
Part IVA – general tax avoidance provisions	125

Example	128
Entitlement to GST input tax credits	128
Detailed contents list	129

Commissioner of Taxation

16 January 2002

<i>Previous draft:</i>	- ITAA 1997 35-25
Not previously issued in draft form	- ITAA 1997 35-30
	- ITAA 1997 35-35
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-40
TR 94/13; TR 97/11; TR 97/16;	- ITAA 1997 35-45
PR 1999/95; PR 1999/27; TR 92/1;	- ITAA 1997 35-55
TR 92/20; TD 93/34; TR 98/22	- ITAA 1997 35-55(1)
	- ITAA 1997 35-55(1)(a)
	- ITAA 1997 35-55(1)(b)
<i>Subject references:</i>	- ITAA 1997 Div 328
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- commencement of business	- ITAA 1997 Subdiv 328-G
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