



# ***PR 2002/49 - Income tax: ITC Sandalwood Project 2002***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *24 April 2002*



# Product Ruling

## Income tax: ITC Sandalwood Project 2002

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### Preamble

*The number, subject heading, and the **What this Product Ruling is about** (Including Tax law(s), Class of persons and Qualifications sections), **Date of effect, Withdrawal, Arrangement and Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

### No guarantee of commercial success

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

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

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

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

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

### Terms of Use of this Product Ruling

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

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

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'ITC Sandalwood Project 2002', the 'Sandalwood Project' or just simply as 'the Project'.

### Tax law(s)

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

### Goods and Services Tax

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

### 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 those who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of 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. Growers that elect to market their own timber produce are also excluded from this Ruling (see paragraphs 49 and 56).

### **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.

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Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## Date of effect

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11. This Ruling applies prospectively from 24 April 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 arrangement incorporates the following documents:

- Application for Product Ruling received 17 December 2001;
- Prospectus issued by ITC Project Management Ltd ('ITCPM'), dated 13 February 2002;

- Draft Supplementary Prospectus, received 4 April 2002;
- Draft **Agreement to enter into Land Agreement**, received 4 April 2002;
- Draft **Management Agreement** for the ITC Sandalwood Project 2002 between ITCPM and the Grower, received 17 December 2001;
- Draft Memorandum (Management Agreement Provisions) for the ITC Sandalwood Project 2002, received 17 December 2001;
- Draft **Land Agreement** for the ITC Sandalwood Project 2002 between ITCPM and the Grower, received 17 December 2001;
- Draft Memorandum (Land Agreement Provisions) for the ITC Sandalwood Project 2002, received 17 December 2001;
- Draft Constitution of the ITC Sandalwood Project 2002, received 17 December 2001;
- Draft Compliance Plan of the ITC Sandalwood Project 2002, received 17 December 2001;
- Additional correspondence from the Applicant dated 22 February 2002, 1 March 2002, 19 March 2002, 4 April 2002 and 16 April 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 that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement to which this Ruling applies.

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

### **Overview**

17. The salient features of the ITC Sandalwood Project 2002 arrangement are as follows:

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Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of Indian Sandalwood trees ( <i>Santalum album</i> ) for the purpose of harvesting and selling timber.
Number of hectares offered for cultivation	160 hectares
Size of each interest (Plantation Unit)	0.07 hectares
Minimum allocation	2 Plantation Units
Number of trees established per hectare	440
Expected production	830 kg per Plantation Unit
The term of the Project	Approximately 15 years
Initial minimum cost	\$2,200 per Plantation Unit plus \$1,100 per Grower if electing the Annual Payment Method; or \$3,850 per Plantation Unit plus \$1,100 per Grower if electing the Single Payment Method.
Subscription for Shares	Growers who elect the Single Payment Method are required to subscribe for 1,500 shares in ITC Timberlands Ltd for each Plantation Unit at an issue price of \$1.10 per share.
Ongoing and other costs (for all Growers)	Planting fees. Lease and Management Fees (either paid annually or deferred until harvest) Additional fees payable from harvest proceeds. Optional insurance costs.

18. The Project will be a Managed Investment Scheme under the Corporations Act. The Responsible Entity for this Project is ITC Project Management Ltd ('ITCPM'). The Prospectus offers the choice of 3 Projects to be managed by the Responsible Entity:

- The ITC Sandalwood Project 2002;
- The ITC Pulpwood Project 2002; and
- The ITC Solidwood Project 2002.

19. This Ruling only applies to the Sandalwood Project for which there is no minimum subscription. Under this Prospectus, ITCPM proposes to offer up to 160 hectares of land situated near the Ord River in Kununurra, Western Australia described as:

- Portion of King Location 255 being the whole of the land contained in Certificate of Title Volume 1594 Folio 621; and
- Portion of King Location 276 being part of the land contained in Certificate of Title Volume 1637 Folio 385.

20. Under this offer, a Grower may enter the Project in either the 2001/2002 income year (defined as a '2002 Grower' for the purpose of this Ruling) or the 2002/2003 income year ('2003 Grower').

21. ITCPM will lease the Project land from ITC Timberlands Ltd, a related entity. Growers participating in the arrangement will enter into a Land Agreement with ITCPM. The Land Agreement is executed over an identifiable area of land called a 'Plantation Unit' of 0.07 hectares and is effective until the trees are harvested and sold and the net income distributed.

22. Growers will also enter into a Management Agreement with ITCPM for the management of their Plantation Area. ITCPM will be responsible for establishing, cultivating and harvesting the trees. The trees are expected to be harvested after approximately 15 years. Unless the Grower elects to take possession of their timber, ITCPM will also arrange for the sale of the timber.

23. Growers may elect to participate in the Project under one of two payment methods. Growers may choose to pay an initial fee on Application and annual fees thereafter ('Annual Payment Method') or an initial fee on Application and defer the balance of the fees until the final harvest ('Single Payment Method'). ITCPM will restrict the allocation of Plantation Units to Single Payment Growers to a maximum of 50%.

24. Each Grower is required to subscribe for a minimum of two Plantation Units. Additionally, Growers electing to pay under the Single Payment Method are required to subscribe for shares in ITC Timberlands Ltd (see paragraph 41).

25. Growers electing to pay fees under the Annual Payment Method are not obliged but are entitled to also subscribe for shares and may also participate as a Joint Venture between two Growers (see paragraphs 44 to 46).

26. Upon application, Growers will execute a Power of Attorney enabling ITCPM to act on their behalf as required. Growers will receive a Certificate detailing the Plantation Units they have been

allocated once the Land Agreement has been executed. The Plantation Units are separately identified on a Plantation Area Map annexed to the Land Agreement.

## **Constitution**

27. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution set out the terms and conditions under which ITCPM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

28. Under the terms of the Constitution, all moneys received from applications shall be paid to ITCPM as the Responsible Entity, which shall deposit those moneys into an Application Fund. The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 8 and 9 of the Constitution).

29. The Responsible Entity will also:

- prepare the Management Agreement and the Land Agreement (clause 6);
- keep a register of Growers (clause 27); and
- distribute profits (clause 30).

## **Compliance plan**

30. ITCPM has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

## **Land Agreement**

31. Upon application, Growers will enter into an Agreement to enter into a Land Agreement. Once suitable land has been procured ITCPM will execute a Land Agreement on behalf of the Grower under the Power of Attorney. Pursuant to the Land Agreement, Growers acquire a leasehold interest and will have a right to use their Plantation Area for the purpose of conducting their afforestation business. The sub-lease will be granted in accordance with the provisions set out in the Memorandum (Land Agreement Provisions).

32. Some of the conditions of the Land Agreement are that the Grower will:

- not use the Plantation Units for a purpose other than growing and harvesting Sandalwood trees (and associated host trees);
- comply with sound silvicultural and environment practices adopted within the forestry industry; and
- comply with all laws and regulations relating to the use and occupancy of the Grower's Plantation Units.

### **Management Agreement**

33. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the Agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultant and other specialist services as may be reasonably necessary. The provisions of the Memorandum (Management Agreement Provisions) are incorporated in the Management Agreement.

34. The services which ITCPM must perform are specified in Schedule 2 of the Memorandum. The services include the following:

#### Item 1 – Primary Services

- procure sufficient Trees to the specifications recommended in the Management Plan;
- prepare the land, in accordance with the Management Plan, for planting; and
- supervise and secure management of the works described above.

#### Item 2 – Planting Services

- plant Sandalwood and any host trees required; and
- supervise and secure management of all works on the Plantation Area.

#### Item 3 – Annual Services, include:

- manage the Tree Crop in accordance with the Management Plan;
- maintain adequate stocking of the plantation by replacing any contiguous area of dead or missing trees;
- maintain the planting mounds by appropriate cultivation and weed control;

- maintain access roads and fire breaks and use all reasonable measures to keep the Plantation Area free from rabbits and other vermin; and
- report on the growth of the trees.

Item 4 – Harvesting and Marketing Services, include:

- prepare a Harvesting plan for the Tree Crop; and
- use reasonable endeavours to arrange for the sale of the Tree Crop and enter into a purchase agreement as agent for the Grower.

35. ITCPM will complete the delivery of all Primary Services within 12 months of the date the Primary Services fee is incurred by the Grower. Similarly, Planting Services will be completed within 12 months of the date the Planting Services fee is incurred by the Grower. Annual Services will be completed by 30 June of each year throughout the term of the Project.

## **Fees**

36. Fees are payable to ITCPM by the Grower in respect of each Plantation Unit. Growers participating in the Project may elect to pay fees under the payment methods described at paragraph 23. Joint Venture Growers (see paragraph 44) will pay only the relevant fees as described in paragraph 45.

### *Annual Payment Method*

37. The following amounts are payable for each Plantation Unit in accordance with Items 1 to 3 of Schedule 3 to the Management Agreement Memorandum and Items 1 & 2 of Schedule 2 to the Land Agreement Memorandum:

- Primary Services fee of \$2,200 payable on or before the date of execution of the Management Agreement;
- Planting Services fee of \$220 payable on 31 October 2002 or on execution of the Management Agreement, whichever is the later;
- Annual Services fee of \$110 payable on 31 October 2002 or execution of the Management Agreement, whichever is the later;
- thereafter, the Annual Services fee will be payable on 31 October of each year during the term of the Management Agreement, indexed at the annual rate of inflation;

- Land fees of \$110 payable on 31 October 2002 or execution of the Land Agreement, whichever is the later; and
- thereafter, the Land fees will be payable on 31 October of each year during the term of the Land Agreement, indexed at the annual rate of inflation.

38. In addition to the amounts payable for each Plantation Unit, the following amounts are payable by each Grower PROVIDED THAT where the Grower participates in two or more of the Projects listed at paragraph 18, the additional sum will be payable only once by the Grower;

- Primary Services fee of \$1,100; and
- Annual Services fee of \$110.

#### *Single Payment Method*

39. The following amounts are payable for each Plantation Unit in accordance with Items 1 to 3 of Schedule 3 to the Management Agreement Memorandum and Items 1 & 2 of Schedule 2 to the Land Agreement Memorandum:

- Primary Services fee of \$3,850 payable on or before the date of execution of the Management Agreement;
- Planting Services fee equal to 2.2% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed by ITCPM to the Non-Selling Growers (see paragraph 49);
- Annual Services fee equal to 15.4% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed by ITCPM to the Non-Selling Growers; and
- Land Fees equal to 15.4% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed by ITCPM to the Non-Selling Growers.

40. In addition to the amounts payable for each Plantation Unit, the following amount is payable by each Grower PROVIDED THAT where the Grower participates in two or more of the Projects listed at paragraph 18, the additional sum will be payable only once by the Grower;

- Primary Services fee of \$1,100 (see Item 1 paragraph 34).

41. Growers choosing the Single Payment Method for the payment of fees must also subscribe for shares in the landowning company,

ITC Timberlands Ltd. Applications must be made for 1,500 shares per Plantation Unit at \$1.10 each. The shares will be a preferred class of shares referred to as 'Project 2002 Class Shares' that carry a cumulative fully franked dividend of 5.5% and will convert to ordinary shares on 1 July 2012, unless investors choose to convert earlier.

### *Other Fees*

42. The Grower is also required to pay ITCPM the following amounts that will be deducted from the Harvest Proceeds:

- the Grower's proportional share of the costs of harvesting (clause 9.4 of the Management Agreement Memorandum); and
- a Harvesting and Marketing Fee equal to 5.5% of the Harvest Proceeds (Item 4 of Schedule 3 to the Management Agreement Memorandum).

43. ITCPM will insure the Plantations against fire and windstorm at its cost until 30 September in the year of planting. Thereafter, ITCPM will arrange insurance of the Plantation Area on behalf of the Grower to cover against fire and windstorm if so requested. Any insurance premium will be payable by the Grower and ITCPM will charge a fee to arrange the insurance.

### **Joint Venture**

44. The Project will also allow two Growers to enter into a Joint Venture. They will be bound by the Joint Venture Terms set out in the Application Form attached to the Prospectus. The Joint Venture option is only available under the Annual Payment Method.

45. Under this Joint Venture:

- the first Joint Venture Grower will be responsible for procuring the Primary Services; and
- the second Joint Venture Grower will be responsible for procuring the ongoing provision of land, Planting Services and Annual Services.

46. The Joint Venture Terms provide that the first Joint Venture Grower will be entitled to 45% of the Joint Venture Property and, in particular, all saleable timber from the Plantation Units, and the second Joint Venture Grower will be entitled to 55%.

**Planting**

47. ITCPM will be responsible for planting trees on the Plantation Units. The species to be planted will be *Santalum album*. The Prospectus states that Sandalwood will be planted with a pot host at a density of 440 stems per hectare. ITCPM will also plant other host trees to encourage the growth of or protect the Sandalwood seedlings or trees. The planting beds will be established in a repeating sequence of two Sandalwood rows, then a long term-host row. Planting Services will be completed within 12 months of the date the Planting fee is incurred.

48. After planting, ITCPM will maintain the trees in accordance with good silvicultural practice. The Plantation will be replanted to maintain adequate stocking of the Plantation in accordance with the Management Plan by replacing any contiguous area of dead or missing trees. Thereafter, ITCPM will manage the Tree Crop in accordance with the Management Plan and good silvicultural practice.

**Harvesting and Sale**

49. Under clause 9.1 of the Management Agreement the Grower may, within 12 months of the execution of their agreement, elect itself to market and arrange for the sale of the Tree Crop, thereby becoming a 'Selling Grower', or ITCPM will use reasonable endeavours to sell the Tree Crop on the behalf of the 'Non-Selling Growers' (Item 5(d) of Schedule 2 to the Management Agreement). This Ruling does not apply to Selling Growers.

50. A single harvest of all trees is expected to take place after 15 years. ITCPM will prepare a Harvesting plan and will manage the harvest in accordance with that plan. All Growers must pay the reasonable costs incurred by ITCPM in relation to the carrying out of the Harvesting. ITCPM will be entitled to 5.5% of the Harvest Proceeds as a fee payable for Harvesting and Marketing Services.

51. The proceeds from the sale of timber of Non-Selling Growers will be paid direct to ITCPM who must deposit them into a Proceeds Fund (clause 3.3(c) of the Constitution). Each Grower will have a share in the Proceeds Fund which will be distributed among the Non-Selling Growers according to their Proportional Interest. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1 of the Constitution.

**Finance**

52. Growers can fund their participation in the Project themselves, borrow from ITC Finance Pty Ltd (a lender associated with the Responsible Entity) or borrow from an independent lender.

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53. Finance is available from ITC Finance Pty Ltd and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The usual terms are listed below but may be otherwise negotiated with ITC Finance Pty Ltd at arms length on full recourse commercial terms:

- application fee of \$250 plus 1% of the loan amount;
- 1 year interest free loan payable in 12 equal monthly instalments;
- principal and interest loans for a period of 3, 5, 7 or 10 years, repayable in monthly instalments;
- interest rate fixed for the term of the loan; and
- security taken over the Grower's Plantation Area and shares in ITC Timberlands Ltd (if any).

54. 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' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate;
- 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 ITC Finance Pty Ltd, are involved in the provision of finance for the Project.

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## **Ruling**

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### **Application of this Ruling**

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

- on or before 30 June 2002, where the Grower has executed a Land Agreement and a Management Agreement on or before that date (2002 Growers); and/or
- on or after 1 July 2002 and before the expiry of the Prospectus, and where the Grower has executed a Land Agreement and a Management Agreement on or between those dates (2003 Growers).

56. The Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the project is accepted and the Project has commenced. This Ruling does not apply to Growers who make an election to market timber produced from their Plantation Units (Selling Growers).

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

#### ***Division 328***

57. For a Grower who is accepted into this Project, the recognition of income and the timing of tax deductions will depend upon whether, in an income year(s), the Grower is an 'STS taxpayer' or is not 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**

58. 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***

59. 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.

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

61. A Grower may operate in its own right in relation to an identified area of land, or in Joint Venture with another Grower as referred to in paragraph 44 above.

### **Deductions for Management fees and Land fees**

#### ***Section 8-1***

62. A Grower who is not an ‘STS taxpayer’ may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Tables.

#### ***Annual Payment Method***

63. Where a Grower (who is not a Joint Venture Grower) elects to pay fees under the Annual Payment Method, the following deductions will be available:

**2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2002</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>
<b>Primary Services</b> – fixed amount	8-1	See Notes (i), (ii) & (iii) below		
<b>Primary Services</b> - per Plantation Unit	8-1	\$2,200 See Notes (i) & (ii) below		
<b>Planting Services</b> - per Plantation Unit	8-1		\$220 See Notes (i) & (ii) below	
<b>Annual Services</b> – fixed amount	8-1		See Notes (i), (iii) & (iv) below	
<b>Annual Services</b> - per Plantation Unit	8-1		\$110 See Notes (i) & (iv) below	\$110 (indexed) See Notes (i), (iv) & (v) below
<b>Land Fees</b> - per Plantation Unit	8-1		\$110 See Notes (i) & (iv) below	\$110 (indexed) See Notes (i), (iv) & (v) below
<b>Interest</b>	8-1	As incurred - See note (vi) below	As incurred – See note (vi) below	As incurred - See note (vi) below

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>	<b>Year ending 30/6/2005</b>
<b>Primary Services</b> – fixed amount	8-1	See Notes (i), (ii) & (iii) below		
<b>Primary Services</b> – per Plantation Unit	8-1	\$2,200 See Notes (i) & (ii) Below		
<b>Planting Services</b> – per Plantation Unit	8-1	\$220 See Notes (i) & (ii) below		
<b>Annual Services</b> - fixed amount	8-1	See Notes (i) & (iii) below		
<b>Annual Services</b> – per Plantation Unit	8-1	\$110  See Note (i) below	\$110 (indexed) See Notes (i), (iv) & (v) below	\$110 (indexed) See Notes (i), (iv) & (v) below
<b>Land Fees</b> - per Plantation Unit	8-1	\$110  See Note (i) below	\$110 (indexed) See Notes (i), (iv) & (v) below	\$110 (indexed) See Notes (i), (iv) & (v) below
<b>Interest</b>	8-1	As incurred - See note (vi) below	As incurred - See note (vi) below	As incurred - See note (vi) below

**Notes:**

- (i) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits):  
Division 27. See Example 1 at paragraph 138.
- (ii) Expenditure for Primary Services (fixed amount and per Plantation Unit) and Planting Services is expenditure for 'seasonally dependent agronomic activities' and is deductible in the income year in which it is incurred (see paragraphs 104 to 108).
- (iii) The fixed components of the Primary Services fee and the Annual Services fee, being amounts of \$1,100 and

\$110 respectively, are deductible in full but will be incurred only once where that Grower participates in two or more of the Projects listed at paragraph 18.

- (iv) The fees shown in the Management Agreement and the Land 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 102 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.
- (v) Annual Services fees and Annual Land fees are subject to indexation after 1 July 2003. The amount will be the prior year fee indexed at the annual rate of inflation.
- (vi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with ITC Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 96 to 108 (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.

#### *Joint Venture Growers*

64. A Joint Venture Grower may claim the following tax deductions:

- for the first Joint Venture Grower, fees in relation to Primary Services and interest (if applicable) as per the Tables at paragraph 63 above; and
- for the second Joint Venture Grower, fees in relation to Planting Services, Annual Services, Land Fees and

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interest (if applicable) as per the Tables at paragraph 63 above.

*Single Payment Method*

65. Where a Grower elects to pay fees under the Single Payment Method, the following deductions will be available:

**2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2002</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>
<b>Primary Services</b> - fixed amount	8-1	See Notes (i), (ii) & (iii) above		
<b>Primary Services</b> - per Plantation Unit	8-1	\$3,850 See Notes (i) & (ii) Above		
<b>Interest</b>	8-1	As incurred - See Note (vi) above	As incurred - See Note (vi) above	As incurred - See Note (vi) above

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>	<b>Year ending 30/6/2005</b>
<b>Primary Services</b> - fixed amount	8-1	See Notes (i), (ii) & (iii) above		
<b>Primary Services</b> - per Plantation Unit	8-1	\$3,850 See Notes (i) & (ii) Above		
<b>Interest</b>	8-1	As incurred - See Note (vi) above	As incurred - See Note (vi) above	As incurred - See Note (vi) above

**Tax outcomes for Growers who are ‘STS taxpayers’****Assessable Income*****Section 6-5***

66. 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.

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

68. A Grower may operate in its own right in relation to an identified area of land, or in Joint Venture with another Grower as referred to in paragraph 44 above.

**Deductions for Management fees and Land fees*****Section 8-1 and section 328-105***

69. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the revenue expenses in the following Tables. However, if, for any reason, an amount shown in the Table 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.

***Annual Payment Method***

70. Where a Grower (who is not a Joint Venture Grower) elects to pay fees under the Annual Payment Method, the following deductions will be available:

**2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2002</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>
<b>Primary Services</b> - fixed amount	8-1 & 328-105	See Notes (vii), (viii) & (ix) below		
<b>Primary Services</b> - per Plantation Unit	8-1 & 328-105	\$2,200 See Notes (vii) & (viii) below		
<b>Planting Services</b> - per Plantation Unit	8-1 & 328-105		\$220 See Notes (vii) & (viii) below	
<b>Annual Services</b> - fixed amount	8-1 & 328-105		See Notes (vii), (ix) & (x) below	
<b>Annual Services</b> - per Plantation Unit	8-1 & 328-105		\$110 See Notes (vii) & (x) below	\$110 (indexed) See Notes (vii), (x) & (xi) below
<b>Land Fees</b> - per Plantation Unit	8-1 & 328-105		\$110 See Notes (vii) & (x) below	\$110 (indexed) See Notes (vii), (x) & (xi) below
<b>Interest</b>	8-1 & 328-105	When paid - See Note (xii) below	When paid - See Note (xii) below	When paid - See Note (xii) below

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>	<b>Year ending 30/6/2005</b>
<b>Primary Services</b> – fixed amount	8-1 & 328-105	See Notes (vii), (viii) & (ix) below		
<b>Primary Services</b> – per Plantation Unit	8-1 & 328-105	\$2,200 See Notes (vii) & (viii) below		
<b>Planting Services</b> – per Plantation Unit	8-1 & 328-105	\$220 See Notes (vii) & (viii) below		
<b>Annual Services</b> - fixed amount	8-1 & 328-105	See Notes (vii) & (ix) below		
<b>Annual Services</b> – per Plantation Unit	8-1 & 328-105	\$110 See Notes (vii) & (x) below	\$110 (indexed) See Notes (vii), (x) & (xi) below	\$110 (indexed) See Notes (vii), (x) & (xi) below
<b>Land Fees</b> - per Plantation Unit	8-1 & 328-105	\$110 See Notes (vii) & (x) below	\$110 (indexed) See Notes (vii), (x) & (xi) below	\$110 (indexed) See Notes (vii), (x) & (xi) below
<b>Interest</b>	8-1 & 328-105	When paid – See Note (xii) below	When paid - See Note (xii) below	When paid - See Note (xii) below

**Notes:**

- (vii) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits):  
Division 27. See Example 1 at paragraph 138.
- (viii) Expenditure for Primary Services (fixed amount and per Plantation Unit) and Planting Services is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the income year in which it is incurred (see paragraphs 104 to 108).
- (ix) The fixed components of the Primary Services fee and the Annual Services fee, being amounts of \$1,100 and

\$110 respectively, are deductible in full but will be incurred only once where that Grower participates in two or more of the Projects listed at paragraph 18.

- (x) The fees shown in the Management Agreement and the Land 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 102 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.
- (xi) Annual Services fees and Annual Land fees are subject to indexation after 1 July 2003. The amount will be the prior year fee indexed at the annual rate of inflation.
- (xii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with ITC Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 96 to 108 (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.

#### *Joint Venture Growers*

71. A Joint Venture Grower may claim the following tax deductions:

- for the first Joint Venture Grower, fees in relation to Primary Services and interest (if applicable) as per the Tables at paragraph 70 above; and
- for the second Joint Venture Grower, fees in relation to Planting Services, Annual Services, Land Fees and

interest (if applicable) as per the Tables at paragraph 70 above.

*Single Payment Method*

72. Where a Grower elects to pay fees under the Single Payment Method, the following deductions will be available:

**2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2002</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>
<b>Primary Services</b> - fixed amount	8-1 & 328-105	See Notes (vii), (viii) & (ix) above		
<b>Primary Services</b> - per Plantation Unit	8-1 & 328-105	\$3,850 See Notes (vii) & (viii) above		
<b>Interest</b>	8-1 & 328-105	When paid - See Note (xii) above	When paid - See Note (xii) above	When paid - See Note (xii) above

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>	<b>Year ending 30/6/2005</b>
<b>Primary Services</b> - fixed amount	8-1 & 328-105	See Notes (vii), (viii) & (ix) above		
<b>Primary Services</b> - per Plantation Unit	8-1 & 328-105	\$3,850 See Notes (vii) & (viii) above		
<b>Interest</b>	8-1 & 328-105	When paid - See Note (xii) above	When paid - See Note (xii) above	When paid - See Note (xii) above

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

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

#### ***Section 35-55 – Commissioner’s discretion***

73. For a Non-Selling Grower who is an individual and who enters the Project during the years ended 30 June 2002 or 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 2002 to 30 June 2017 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 (see paragraph 132).

74. 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; or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a 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)).

75. Where the ‘exception’ in subsection 35-10(4) applies, or 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 the deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

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

#### **Section 82KL and Part IVA**

77. For a Grower who participates in the Project and incurs expenditure as required by the Land Agreement and the Management 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?**

78. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's activities as a participant in the ITC Sandalwood Project 2002 must amount to the carrying on of a business of primary production.

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

80. For schemes such as that of the ITC Sandalwood Project 2002, 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.

81. Generally, an investor will be carrying on a business of afforestation, and hence primary production, if:

- the Grower has an identifiable interest (by lease or licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber 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 an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

82. In this Project each Grower enters into a Land Agreement and a Management Agreement.

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83. Under the Land Agreement each individual Grower will have rights over a specific and identifiable area of at least 2 hectares of land. The Agreement provides the Grower with an ongoing interest in the specific trees on the Plantation Area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Agreement allows the Responsible Entity to come onto the land to carry out its obligations.

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

85. The Responsible Entity may also be engaged to harvest and sell, on the Grower behalf, the timber grown on the Grower's Plantation Area.

86. 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.

87. 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 timber 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.

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

89. The Responsible Entity's services are also consistent with general afforestation practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of two Plantation Units is relatively small, the minimum allocation is of a size and scale to allow it to be commercially viable. (See Taxation Ruling IT 360).

90. The Grower's degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Plantation Area and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements

with the Responsible Entity in certain instances, such as cases of default or neglect.

91. 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 Grower’s afforestation activities in the ITC Sandalwood Project 2002 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

92. 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.

93. 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 Land and management fees**

### ***Section 8-1***

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

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

95. The management fees (Primary Services, Planting Services and Annual Services) and Land 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 timber 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. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Prepayments provisions**

#### ***Sections 82KZL to 82KZMG***

96. 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.

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

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

98. 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 paragraph 102 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)).

99. 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;
- 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.

100. 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 ITC Finance Pty Ltd. 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.

101. 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.

102. 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.

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

103. 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***

104. 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).

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

- incurred on or after 2 October 2001 and on or before 30 June 2006;
- 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.

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

- it must be an agreement for planting and tending trees for felling; and
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and
- either:
  - (i) there must be more than one participant in the agreement in the same capacity as the taxpayer who incurs the expenditure; or
  - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

107. 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.

108. 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*

109. Under the Management Agreement, a Grower incurs a first year fee for Primary Services and a second year fee for Planting Services. These fees consist of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the Grower's Commencement Date for the expenditure incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

110. Where Growers pay fees under the Annual Payment Method, the Management Agreement requires that a Grower incurs a fee for Annual Services each year for the performance of maintenance services during the term of the Project. Under the Land Agreement a Grower incurs Land Fees to lease land during the term of the Project.

111. The Annual Services fees incurred under the Management Agreement and the Land Fees incurred under the Land Agreement are not prepaid. These fees are charged for providing planting and maintenance services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

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

112. Although not required under either the Management Agreement, the Land Agreement, or the Loan Agreement with ITC Finance Pty Ltd, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this

occurs, contrary to the conclusion reached in paragraph 111 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

113. For these Growers, the amount and timing of deductions for any relevant prepaid Annual Services Fees, prepaid Land 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.

114. 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.

### **Interest deductibility**

#### ***(i) Growers who use ITC Finance Pty Ltd as the finance provider***

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

116. The interest incurred for the year ended 30 June 2002 or 30 June 2003, for 2002 Growers and 2003 Growers respectively, and in subsequent years of income, will be in respect of a loan to finance the Project business operations of growing trees and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

117. As with the management fees and the Land Fees, in the absence of any application of the prepayment provisions (see paragraphs 96 to 103), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

119. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Grower. If interest 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.

***(ii) Growers who DO NOT use ITC Finance Pty Ltd as the finance provider***

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

121. 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 relevant prepayments provisions of the ITAA 1936 (see paragraphs 96 to 103).

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

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

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

123. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

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

125. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable

income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

126. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

127. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Non-Selling Grower who acquires the minimum allocation in the Project of two Plantation Units during the years ended 30 June 2002 or 30 June 2003, is unlikely to have their activity pass one of the tests until the year ended 30 June 2018.

128. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

129. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years:

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

130. Information provided with this Product Ruling indicates that a Non-Selling Grower who acquires the minimum allocation of two Plantation Units in the Project is expected to be carrying on a business activity that will pass one of the tests for the income year ended 30 June 2018.

131. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2017.

132. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). However, the Project may fail to be carried on during the income years specified above (see paragraph 73) in the manner described in the Arrangement (see paragraphs 14 to 54). 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) the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

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

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

### **Section 82KL**

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

**Part IVA**

135. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

136. The ITC Sandalwood Project 2002 will be a 'scheme' commencing with the issue of the Prospectus. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 62 to 72 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

**Example****Example 1 - Entitlement to GST input tax credits**

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

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

\*Taxable supply

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

$$\frac{1}{11} \times \$4,400 = \$400.$$

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:

$$\frac{1}{11} \times \$2,200 = \$200.$$

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

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

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

## **Detailed contents list**

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**Commissioner of Taxation**

24 April 2002

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*Previous draft:*

Not previously issued in draft form

# PR 2002/49

*Related Rulings/Determinations:*

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

*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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