



PR 2002/55 - Income tax: Pinetec Woodlot Project 2002

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 May 2002*



Product Ruling

Income tax: Pinetec Woodlot 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.

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Pinetec Woodlot Project 2002' or simply as 'the Project'.

Tax law(s)

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

Goods and Services Tax

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

Changes in the Law

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

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 Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about 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 these persons are referred to as 'Growers'.

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

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the 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 1 May 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 described below. This description incorporates the following documents:

- Application for Product Ruling, dated 11 February 2002;
- **Draft Pinetec Woodlot Project 2002 Product Disclosure Statement, prepared and issued by Pinetec Limited ('Pinetec'), dated 26 March 2002;**
- **Draft Constitution for Pinetec Woodlot Project 2002 between Alliance RE Ltd ('Alliance RE') and the Grower, undated;**

- **Draft Lease and Management Agreement for Pinetec Woodlot Project 2002 ('the Agreement') between Alliance RE and Pinetec Properties Pty Ltd ('the Lessor') and the Grower, undated;**
- Draft Compliance Plan for Pinetec Woodlot Project 2002 adopted by Alliance RE as 'the Responsible Entity', undated;
- Project Management Agreement between Alliance RE and Pinetec Plantations Pty Ltd ('the Project Manager') and Pinetec Ltd ('the Guarantor'), undated;
- Plantation Management Agreement between Pinetec Plantations Pty Ltd ('the Project Manager') and Pinetec Treefarms Pty Ltd ('the Plantation Manager'), undated;
- Independent Forester's Report, dated 26 February 2002;
- Offtake Agreement between Alliance RE and Pinetec Limited, undated;
- Deed of Priority between the Bank, Alliance RE and Pinetec Properties Pty Ltd ('the Customer'), undated; and
- Additional correspondence received from the applicant, dated 1 March 2002, 11 March 2002, 13 March 2002, 15 March 2002, 20 March 2002, 26 March 2002, 15 April 2002, 16 April 2002, 17 April 2002, 18 April 2002 and 23 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 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.

PR 2002/55**Overview**

17. The arrangement is called the Pinetec Woodlot Project 2002.

Location	The Esperance region of Western Australia. Land located at an average economical haulage distance of no more than 110 km from the Esperance port.
Type of business each participant is carrying on	Pine/Bluegum Interest - Commercial growing, and cultivation of <i>Eucalyptus globulus</i> (Tasmanian Bluegums) and <i>Pinus radiata</i> (Radiata pine) for the purpose of producing timber for pulpwood, hardwood, veneer and sawlog. Bluegum Interest - Commercial growing, and cultivation of <i>Eucalyptus globulus</i> (Tasmanian Bluegums) for the purpose of producing timber for hardwood pulpwood.
Number of hectares to be under cultivation	This Product Disclosure Statement provides for 1,200 hectares to be planted.
Minimum Application	Minimum of 2 Woodlots per applicant.
Size of each Woodlot	1 hectare
Number of trees per hectare	1,449 <i>Radiata pines</i> per hectare 1,000 <i>Tasmanian bluegum</i> per hectare
Term of the investment	Pine/Bluegum Interest - 26 years Bluegum Interest - 12 years
Initial cost per Woodlot	Pine/Bluegum Interest Option A - \$5,500 Option B - \$3,630 Bluegum Interest - \$3,630
Initial cost per hectare	Pine/Bluegum Interest Option A - \$5,500 Option B - \$3,630 Bluegum Interest - \$3,630
Ongoing costs	Management Fee, Rent, Insurance, pruning fees for the Pine/Bluegum Interest and harvesting fees. Alliance RE must reimburse the Project Manager for the costs of harvesting, processing and the cost of sales from the gross proceeds of sale.
Other costs	Purchase of at least 2,800 shares in Pinetec Ltd.

18. The Project will be conducted on land located in the Esperance region of Western Australia being several parcels of land contained in Certificate of Title Volume 124 Folio 75A and Volume 1688 Folio 390-392. Growers participating in the arrangement will enter into a Lease and Management Agreement between Alliance RE (as Responsible Entity) and Pinetec Properties Pty Ltd (as Lessor) and the Grower. This agreement is set out in the First Schedule to the Constitution. The Agreement gives a Grower a lease from Pinetec Properties Pty Ltd over an identifiable area of land called a 'Leased Area' until the expiry of the lease in accordance with Item 4 of the Schedule to the Lease and Management Agreement. Each Leased Area is 1 hectare in size.

19. The Grower engages Alliance RE to carry out the management of their Woodlot. Alliance RE will establish and cultivate *Radiata pine* and *Tasmanian bluegum* and be responsible for pruning, harvesting, processing, marketing and selling the timber. Growers may elect, when completing the Application to subscribe for Woodlots, to collect their own Collectable Produce by marking the relevant section of the Application and thereby become an Electing Grower (clause 1 and clause 15) or the Responsible Entity will sell the forest produce on behalf of the Non-Electing Growers for the maximum practicable price (clause 17 and item 7D of the Schedule).

20. Under the Product Disclosure Statement, Pinetec proposes to offer 1,200 Woodlots of 1 hectare, which will be planted with *Radiata pine* and/or *Tasmanian bluegum* seedlings following execution of a Lease and Management Agreement. Subject to suitable land being available, further Woodlots will be issued if more than 1,200 Woodlots are subscribed for. The Product Disclosure Statement states that there is no minimum subscription for this Project. Each Grower may subscribe for a minimum of two Woodlots at a cost of \$4,950 per Woodlot under the Pine/Bluegum Interest - Option A and \$3,300 under the Pine/Bluegum Interest - Option B and the Bluegum Interest.

21. A Grower who subscribes for a Pine/Bluegum Interest will be allotted an area of approximately 0.66 hectares that will be planted with approximately 966 *Radiata pine* seedlings and an area of approximately 0.33 hectares that will be planted with approximately 333 *Tasmanian bluegum* Seedlings. A Grower who subscribes for a Bluegum Interest will be allotted a complete hectare of land that will be planted with approximately 1,000 *Tasmanian bluegum* seedlings.

22. The date of a Grower's application determines the date of execution of the Lease and Management Agreement and the period of provision of Primary Services to which the Primary Services Fee relates.

23. Growers will execute a Power of Attorney enabling the Responsible Entity, Alliance RE, to act on their behalf as required when they make an application for Woodlots.

24. Each Grower must also subscribe for one thousand four hundred shares in Pinetec Limited per Woodlot subscribed for.

Constitution

25. The relevant Constitution establishes the Project and operates as a deed binding on all of the Growers of the Project and the Responsible Entity. The Constitution sets out the terms and conditions under which Alliance RE agrees to act as Responsible Entity and thereby manage the Project. The Lease and Management Agreement is annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Product Disclosure Statement. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 26 of the Constitution, the Responsible Entity will keep a register of Growers, identifying the Woodlots held by Growers. Growers may assign their interest only in certain circumstances as set out in clause 21 of the Lease and Management Agreement.

Compliance Plan

26. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. The Compliance Plan's 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.

Lease and Management Agreement

27. The Lease and Management Agreement sets out the roles and obligations of the parties to the agreement. It is entered into between the Responsible Entity, the Lessor and the Grower for each Leased Area. Under the agreement the Lessor grants a Lease to the Grower and the Grower appoints the Responsible Entity to establish, maintain, harvest, process and sell the trees on the Grower's Woodlot.

28. The agreement commences on the date the Grower's Application is accepted by the Responsible Entity. The Project is terminated pursuant to the provisions of the agreement or, upon distribution of net income to Growers following final harvest and sale of the Forest Produce. Therefore, the arrangement will terminate with regards to the areas of the Woodlot upon which *Tasmanian bluegum*

trees are planted following harvest in approximately year 12 after the Initial Period and with regards to the areas of the Woodlot upon which *Radiata pine* trees are planted following final harvest in approximately year 26 after the Initial Period.

29. Growers participating in the Project are granted an interest in land by the Lessor in the form of a lease to use their Leased Area for the purpose of conducting a long-term commercial afforestation business.

30. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement. The services to be performed are specified in the definitions of 'Primary Services', 'Planting Services', 'Management Services' and 'Selling Services'. The Responsible Entity will supervise and manage all silvicultural activities to be carried out on the Woodlot on behalf of the Grower including, but not limited to the provision of the following services:

- (i) Primary Services:
 - acquire appropriate seeds and seedlings; and
 - carry out weed control and ground preparation of the Leased Area.
- (ii) Planting Services:
 - Plant in accordance with good silvicultural and afforestation practices *Radiata pine* seedlings at a rate of approximately 1,449 per hectare and *Tasmanian bluegum* seedlings at a rate of approximately 1,000 per hectare.
- (iii) Management Services:
 - cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the trees;
 - replant contiguous areas of more than one hectare with sufficient seedlings or trees to ensure that there are at least, 1,232 *Radiata pine* seedlings or trees per hectare and 850 *Tasmanian bluegum* seedlings or trees per hectare;
 - keep access roads and firebreaks in good repair and the Woodlot free from rabbits and other vermin;
 - maintain the Woodlot according to good silvicultural and afforestation practices; and

- carry out or arrange for Pruning, Harvesting and Processing of trees to be carried out.

Fees

31. Under the terms of the Lease and Management Agreement a Grower will make payments per Woodlot as described below.

32. A **Primary Services Fee** is payable on Application for services to be provided in the Initial Period. The fee payable is \$4,950 (Pine/Bluegum Interest - Option A) or \$3,300 (Pine/Bluegum Interest - Option B and Bluegum Interest) per Woodlot.

33. A **Planting Fee** is payable on 30 September of the Financial Year after the Initial Period. The fee payable for services to be provided in the First Period is \$550 (Pine/Bluegum Interest - Option A) or \$330 (Pine/Bluegum Interest - Option B and Bluegum Interest) per Woodlot.

34. **Rent** payable by each Grower is determined according to whether the Woodlot relates to a Pine/Bluegum Interest Option A, a Pine/Bluegum Interest Option B or a Bluegum Interest. Each Grower who participates in the Project will pay the following Rent per Woodlot to the Lessor:

- Pine/Bluegum Option A - An amount of 7% of Net Proceeds of Sale. Payment of Rent is deferred until the years in which harvest proceeds are received;
- Pine/Bluegum Option B - An amount of \$264 per annum, indexed each year at the annual rate of inflation, payable on 30 April in each year after the Initial Period to year 10. Following Year 10 payment of Rent is deferred until the years in which harvest proceeds are received. The deferred Rent is an amount of 2% of Net Proceeds of Sale; or
- Bluegum Interest - An amount of \$154 per annum, indexed each year at the annual rate of inflation, payable on 30 April in each year after the Initial Period.

35. The Responsible Entity is entitled to a **Management Fee** in consideration of it performing the Management Services for each Financial Year following the Initial Period. The Management Fee payable by each Grower is determined according to whether the Woodlot relates to a Pine/Bluegum Interest Option A, a Pine/Bluegum Interest Option B or a Bluegum Interest. Each Grower who participates in the Project will pay the following Management Fee per Woodlot to the Responsible Entity:

- Pine/Bluegum Option A - An amount of 8% of the Net Proceeds of Sale. Payment of the Management Fee is deferred until the years in which harvest proceeds are received;
- Pine/Bluegum Option B - An amount of \$121 per annum, indexed each year at the annual rate of inflation, payable on 30 April in each year after the Initial Period to year 10. Following Year 10 payment of Management Fees is deferred until the years in which harvest proceeds are received. The deferred Management Fee is an amount of 3% of Net Proceeds of Sale; or
- Bluegum Interest - An amount of \$82.50 per annum, indexed each year at the annual rate of inflation, payable on 30 April in each year after the Initial Period.

Other Fees

36. Three years after the end of the Initial Period Growers will be charged for the **cost of insurance** against destruction or damage of the Leased Area by fire and other usual risks for each Woodlot. Irrespective of how many Woodlots are held by a Grower, an annual administration fee of \$40 (indexed) per Grower will be payable to Alliance RE for arranging the insurance.

37. The Responsible Entity will invoice the Grower for the **cost of pruning *Radiata pine*** in years 4, 6 and 8 of the Project.

Plantation Establishment

38. The date of execution of the Lease and Management Agreement will determine the period of provision of the Primary Services and the Planting Services to which the Primary Services Fee and the Planting Fee relate. The relevant periods for execution of the Lease and Management Agreement are summarised as follows:

- on or before 25 June 2002 and during the period after 25 June 2002 and on or before 30 June 2002, where Alliance RE executes an Agreement where it considers that the Primary Services can be performed by 30 June 2002, ('2002 Growers');
- on or after 1 July 2002 and on or before 25 June 2003 and during the period after 25 June 2003 and on or before 30 June 2003, where Alliance RE executes an Agreement where it considers that the Primary Services

can be performed by 30 June 2003, ('2003 Growers'); and

- on or after 26 June in the 2002 and 2003 Financial Years where Alliance RE exercises its discretion to execute the Agreement but does not intend the Primary Services to be performed until the following Financial Year, ('Prepaid Growers').

39. After 25 June 2002 and 2003 and on or before 30 June 2002 and 2003 Alliance RE will be monitoring on a daily basis its ability to complete the Primary Services by 30 June of the year of Application. Where Alliance RE receives an Application for Woodlots during this period and considers that the Primary Services can not be completed by 30 June of that Financial Year, Alliance RE may exercise a discretion to accept the Grower as a Prepaid Grower. Alternatively, Alliance RE may accept the Grower as a 2003 Grower by executing the Lease and Management Agreement on or after 1 July 2002.

40. The Primary Services will be performed during the Initial Period, being from the Commencement date to the following 30 June for 2002 Growers and 2003 Growers. Where Alliance RE exercises its discretion to accept a Prepaid Grower the Primary Services will be performed during the Initial Period commencing on the following 1 July until the following 30 June. The Planting Services will be performed during the Financial Year that commences at the end of the Initial Period. After the Initial Period, Alliance RE will maintain the Grower's Woodlots in accordance with good silvicultural practice. The services to be provided by Alliance RE over the term of the Project are defined in items 7C and 7D of the Lease and Management Agreement.

41. The Responsible Entity will not undertake any work on behalf of a Grower on a Leased Area prior to the Grower subscribing for an interest in the Project.

Harvesting

42. At all times the Grower has full right, title and interest in the forest produce and the right to have the forest produce sold for their benefit (clause 16.1). Unless the Grower elects to take possession of their timber, the Responsible Entity will arrange the marketing and sale of the forest produce.

43. Harvesting and processing of some of the *Radiata pine* is to be carried out at approximately 12 years and 18 years after the initial period. The balance of the *Radiata pine* will be harvested at approximately 26 years after the end of the initial period. The Responsible Entity will harvest and process the *Tasmanian bluegum*

trees approximately 12 years after the initial period (clause 14.1 of the Lease and Management Agreement).

44. Alliance RE will ensure that the Gross Proceeds of Sale of the Project are paid into the Proceeds Fund trust account. The Growers' proportional share of the costs incidental to the Harvesting, Processing and Sale of the produce will be paid from the Gross Proceeds of Sale to the Project Manager. From the Net Proceeds of Sale Alliance RE will receive any outstanding fees due and payable, including the relevant Grower's Proportional Share of the Management Fee and any other amounts payable by the Grower under the terms of the Lease and Management Agreement and the Constitution as remuneration for the services provided. The Lessor will receive any outstanding fees due and payable, including the relevant Grower's Proportional Share of the Rent and any other amounts payable by the Grower under the terms of the Lease and Management Agreement and the Constitution. The balance of the Net Proceeds of Sale will be distributed to the Non-Electing Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Proportional Share' are defined in clause 1 of the Lease and Management Agreement.

45. If a Grower is an 'Electing Grower', the Grower's proportional share of the costs of pruning, harvesting, processing, Rent owed to the Lessor, the Responsible Entity's remuneration and any other amount due and payable under the Lease and Management Agreement, are due for payment at the time of collection specified by the Responsible Entity for collection of the Electing Grower's Collectable Produce (clause 15.2 and 15.5).

Finance

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

47. 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

48. This Ruling applies only to Growers who are accepted to participate in the Project as 2002 Growers, 2003 Growers or Prepaid Growers and who have executed a Lease and Management Agreement on or before 30 June 2003. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

49. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to those Growers who make an election under the Lease and Management Agreement to take delivery of and market the timber produced from their Woodlot(s).

50. For 2002 Growers and Prepaid Growers, who are accepted to participate in the Project on or before 30 June 2002, references in the following paragraphs to Year 1, Year 2 and Year 3 are references to the income years ended 30 June 2002, 30 June 2003 and 30 June 2004 respectively. For 2003 Growers and Prepaid Growers, who are accepted to participate in the Project on or before 30 June 2003, references in the following paragraphs to Year 1, Year 2 and Year 3 are references to the income years ended 30 June 2003, 30 June 2004 and 30 June 2005 respectively.

The Simplified Tax System ('STS')

Division 328

51. 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

52. 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

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

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

Deductions for Primary Services Fees, Planting Fees, Management Fees and Rent

Section 8-1

55. A Grower who is not an 'STS taxpayer' may claim tax deductions under section 8-1 of the ITAA 1997, for the following revenue expenses for each Woodlot contained in the Grower's Plantation. Deductions will be available in accordance with the year in which the Grower commences participation in the Project, being Year 1 in the following Tables.

PR 2002/55**Year 2002 Growers and Year 2003 Growers*****Pine/Bluegum Interest - Option A***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$4,950– See Notes (i) & (iv) (below)		
Planting Fee	8-1		\$550 - See Notes (i) & (iii) (below)	

Pine/Bluegum Interest - Option B

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$3,300 - See Notes (i) & (iv) (below)		
Planting Fee	8-1		\$330 - See Notes (i) & (iii) (below)	
Management Fee	8-1		\$121 (indexed) - See Notes (i) & (iv) (below)	As incurred - See Notes (i) & (iv) (below)
Rent Fee	8-1		\$264 (indexed) - See Notes (i) & (iv) (below)	As incurred - See Notes (i) & (iv) (below)

Bluegum Interest

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$3,300 - See Notes (i) & (iv) (below)		
Planting Fee	8-1		\$330 - See Notes (i) & (iii) (below)	
Management Fee	8-1		\$82.50 (indexed) - See Notes (i) & (iv) (below)	As incurred - See Notes (i) & (iv) (below)
Rent Fee	8-1		\$154 (indexed) - See Notes (i) & (iv) (below)	As incurred - See Notes (i) & (iv) (below)

Prepaid Growers***Pine/Bluegum Interest - Option A***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$4,950 - See Notes (i) & (ii) (below)		
Planting Fee	8-1			\$550 - See Notes (i) & (iii) (below)

PR 2002/55***Pine/Bluegum Interest - Option B***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$3,300 - See Notes (i) & (ii) (below)		
Planting Fee	8-1			\$330 - See Notes (i) & (iii) (below)
Management Fee	8-1			\$121 (indexed) - See Notes (i) & (iv) (below)
Rent Fee	8-1			\$264 (indexed) - See Notes (i) & (iv) (below)

Bluegum Interest

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1	\$3,300 - See Notes (i) & (ii) (below)		
Planting Fee	8-1			\$330 - See Notes (i) & (iii) (below)
Management Fee	8-1			\$82.50 (indexed) - See Notes (i) & (iv) (below)
Rent Fee	8-1			\$154 (indexed) - See Notes (i) & (iv) (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 129.
- (ii) Where the Grower is a Prepaid Grower, the Primary Services Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 98 to 102) and is deductible in the income year in which it is incurred.
- (iii) Where a Grower is not an 'STS taxpayer', the Planting Fee shown in the Lease and Management Agreement is deductible in full in the year that it is incurred. However, if a Grower **chooses** to prepay the Planting Fee during the Initial Period for the provision of the Planting Services, the Planting Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraph 98 to 102) and is deductible in the income year in which it is incurred under section 82KZMG of the ITAA 1936. If a Prepaid Grower **chooses** to prepay the Planting Fee in the income year they commence participation in the Project for the doing of a thing (e.g., the provision of Planting Services) that will not be wholly done on or before the last day of the year of income after the expenditure year, the requirements of section 82KZMG are not met and the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 90 to 97). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 96 unless the expenditure is 'excluded expenditure'.
- (iv) For a Grower who is a 2002 Grower or a 2003 Grower, the Primary Services Fee, Management Fees and Rent fees shown in the Lease and Management are deductible in full in the year that they are incurred. For a Grower who is a Prepaid Grower, the Management Fees and the Rent fees shown in the Lease and Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay Management Fees or Rent 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 96 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 and Section 328-105

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

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

Deductions for Primary Services Fees, Planting Fee, Management fees and Rent fees

Sections 8-1 and 328-105

58. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses for each Woodlot contained in the Grower's Plantation. However, if for any reason, an amount shown in the Tables below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid. Deductions will be available in accordance with the year in which the Grower commences participation in the Project, being Year 1 in the following Tables.

Year 2002 Growers and Year 2003 Growers***Pine/Bluegum Interest - Option A***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$4,950 – See Notes (v) & (viii) (below)		
Planting Fee	8-1 & 328-105		\$550 - See Notes (v) & (vii) (below)	

Pine/Bluegum Interest - Option B

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$3,300 - See Notes (v) & (viii) (below)		
Planting Fee	8-1 & 328-105		\$330 - See Notes (v) & (vii) (below)	
Management Fee	8-1 & 328-105		\$121 (indexed) - See Notes (v) & (viii) (below)	When paid - See Notes (v) & (viii) (below)
Rent Fee	8-1 & 328-105		\$264 (indexed) - See Notes (v) & (viii) (below)	When paid - See Notes (v) & (viii) (below)

PR 2002/55***Bluegum Interest***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$3,300 - See Notes (v) & (viii) (below)		
Planting Fee	8-1 & 328-105		\$330 - See Notes (v) & (vii) (below)	
Management Fee	8-1 & 328-105		\$82.50 (indexed) - See Notes (v) & (viii) (below)	When paid - See Notes (v) & (viii) (below)
Rent Fee	8-1 & 328-105		\$154 (indexed) - See Notes (v) & (viii) (below)	When paid - See Notes (v) & (viii) (below)

Prepaid Growers***Pine/Bluegum Interest - Option A***

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$4,950- See Notes (v) & (vi) (below)		
Planting Fee	8-1 & 328-105			\$550 - See Notes (v) & (vii) (below)

Pine/Bluegum Interest - Option B

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$3,300 - See Notes (v) & (vi) (below)		
Planting Fee	8-1 & 328-105			\$330 - See Notes (v) & (vii) (below)
Management Fee	8-1 & 328-105			\$121 (indexed) - See Notes (v) & (viii) (below)
Rent Fee	8-1 & 328-105			\$264 (indexed) - See Notes (v) & (viii) (below)

Bluegum Interest

Fee Type	ITAA 1997 Section	Year 1	Year 2	Year 3
Primary Services Fee	8-1 & 328-105	\$3,300 - See Notes (v) & (vi) (below)		
Planting Fee	8-1 & 328-105			\$330 - See Notes (v) & (vii) (below)
Management Fee	8-1 & 328-105			\$82.50 (indexed) - See Notes (v) & (viii) (below)
Rent Fee	8-1 & 328-105			\$154 (indexed) - See Notes (v) & (viii) (below)

Notes:

- (v) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example at paragraph 129.
- (vi) Where the Grower is a Prepaid Grower, the Primary Services Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 98 to 102) and is deductible in the income year in which it is paid.
- (vii) Where a Grower is an 'STS taxpayer', the Planting Fee shown in the Lease and Management Agreement is deductible in full in the year that it is paid. However, if a Grower **chooses** to prepay the fee during the Initial Period for the provision of the Planting Services, the Planting Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 98 to 102) and is deductible in the income year in which it is paid under section 82KZMG of the ITAA 1936. If a Prepaid Grower **chooses** to prepay the Planting Fee in the income year they commence participation in the Project for the doing of a thing (e.g., the provision of Planting Services) that will not be wholly done on or before the last day of the year of income after the expenditure year, the requirements of section 82KZMG are not met and the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 90 to 97). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 96 unless the expenditure is 'excluded expenditure'.
- (viii) Where a Grower who is a 2002 Grower or a 2003 Grower, who is an 'STS taxpayer', pays the Primary Services Fee, Management fees and the Rent fees in the relevant income years shown in the Lease and Management Agreement, those fees are deductible in full in the year that they are paid. Where a Grower who is a Prepaid Grower pays the Management Fees and the Rent fees in the relevant income years shown in the Lease and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay Management Fees or Rent 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 90 to

97). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 96, 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

59. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 88 to 89 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

60. For a Grower who is an individual and who enters the Project during the year 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. The Commissioner will decide 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:

- for 2002 Growers who participate in a Pine/Bluegum Interest (Option A or B), for the income years ending 30 June 2002 to 30 June 2027;
- for Prepaid Growers who enter into the Project during the year ended 30 June 2002 and participate in a Pine/Bluegum Interest (Option A or B), for the income years ending 30 June 2002 to 30 June 2028;
- for 2002 Growers who participate in a Bluegum Interest, for the income years ending 30 June 2002 to 30 June 2013;

- for Prepaid Growers who enter into the Project during the year ended 30 June 2002 and participate in a Bluegum Interest, for the income years ending 30 June 2002 to 30 June 2014;
- for 2003 Growers who participate in a Pine/Bluegum Interest (Option A or B), for the income years ending 30 June 2003 to 30 June 2028;
- for prepaid Growers who enter into the Project during the year ended 30 June 2003 and participate in a Pine/Bluegum Interest (Option A or B), for the income years ending 30 June 2003 to 30 June 2029;
- for 2003 Growers who participate in a Bluegum Interest, for the income years ending 30 June 2003 to 30 June 2014; and
- for Prepaid Growers who enter into the Project during the year ended 30 June 2003 and participate in a Bluegum Interest, for the income years ending 30 June 2003 to 30 June 2015.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 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; 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)).

62. Where, the ‘exception’ in subsection 35-10(4) applies, the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

63. 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

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

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

65. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Pinetec Woodlot Project 2002 must amount to the carrying on of a business of primary production.

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

67. For schemes such as that of the Pinetec Woodlot 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, 16 ATR 455.

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

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the Forest Produce from those trees;

- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

69. In this Project, each Grower enters into a Lease and Management Agreement.

70. Under the Lease and Management Agreement each individual Grower will have rights over a specific and identifiable area of a minimum of 2 hectares of land. The Lease and Management Agreement provides the Grower with an ongoing interest in the specific trees on the leased 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 Lease allows the Project Manager to come onto the land to carry out its obligations under the Lease and Management Agreement.

71. Under the Lease and Management Agreement Alliance RE 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 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 on the Grower's behalf.

72. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the Forest Produce grown on the Grower's Plantation.

73. 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.

74. 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 Forest 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.

75. The pooling of Forest Produce from trees grown on the Grower's Plantation with the Forest Produce of other Growers is consistent with general afforestation 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.

76. The Responsible Entity's services are also consistent with general silvicultural practices. They are of the type ordinarily found in

afforestation ventures that would commonly be said to be businesses. While the size of a Plantation is relatively small, it is of a size and scale to allow it to be commercially viable. (See Taxation Ruling IT 360).

77. The Grower's degree of control over the Responsible Entity as evidenced by the Lease and Management Agreement is sufficient. During the term of the Project, the Responsible Entity 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 Responsible Entity in certain instances, such as cases of default or neglect.

78. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the Pinetec Woodlot Project 2002 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

79. 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.

80. 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 Primary Services Fees, Planting Fees, Management Fees and Rent

Section 8-1

81. Consideration of whether the Primary Services Fee, Planting Fee, Management Fees and Rent 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.

82. The Primary Services Fee, Planting Fee, Management Fees and Rent 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 forest 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 Primary Services Fee, Planting Fee or Management Fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

83. Under the Lease and Management Agreement neither the Primary Services Fees, Planting Fees, Management Fees nor the Rent, other than the Primary Services Fee where a Grower is a Prepaid Grower, 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.

84. However, where a Grower **chooses** to prepay the Planting Fee, Management Fees or the Rent for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 90 to 102) 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

85. In the absence of any application of the prepayment provisions, the timing of deductions for the Primary Services Fee, Planting Fee, Management fees and Rent will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

86. If the Grower is not an 'STS taxpayer', the Primary Services Fee, Planting Fee, Management Fees and Rent fees are deductible in the year in which they are incurred.

87. If the Grower is an 'STS taxpayer' the Primary Services Fee, Planting Fee, Management Fees and Rent 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**

88. 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.

89. 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 90 to 97).

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

90. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (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.

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

Sections 82KZME and 82KZMF

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

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

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

94. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier.

Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

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

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

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

97. 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

98. 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).

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

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

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

101. 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.

102. 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

103. Under the Lease and Management Agreement, a Prepaid Grower incurs a Primary Services Fee consisting of expenditure of \$4,950 (Pine/Bluegum Interest - Option A) or \$3,300 (Pine/Bluegum Interest - Option B or Bluegum Interest) per Woodlot, for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June in the year the Prepaid Grower commences to participate in the Project for the Primary Services Fee incurred under the Lease and Management Agreement for 'seasonally dependent agronomic activities'.

104. The Lease and Management Agreement also requires that a Grower incurs a Planting Fee \$550 (Pine/Bluegum Interest - Option A) or \$330 (Pine/Bluegum Interest - Option B or Bluegum Interest)

per Woodlot, Management Fees for the performance of Management Services during the term of the Project and Rent to lease land during the term of the Project. In addition, the Lease and Management Agreement requires that a 2002 Grower and a 2003 Grower incurs a Primary Services fee, of \$4,950 (Pine/Bluegum Interest - Option A) or \$3,300 (Pine/Bluegum Interest - Option B or Bluegum Interest) per Woodlot which is payable on Application, for the performance of Primary Services during the Initial Period.

105. The Planting Fee, Management Fees and Rent incurred under the Lease and Management Agreement are not prepaid. The Primary Services Fee incurred by 2002 Growers and 2003 Growers under the Lease and Management Agreement are not prepaid. These fees are charged for providing Primary Services, Planting Services, Management Services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred.

106. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the Planting Fees, Management Fees and Rent.

107. 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 the Planting Fee for a period in excess of that required by the Project's agreements

108. Although not required under the Lease and Management Agreement, a Grower participating in the Project may **choose** to prepay the Planting Fee for a period beyond the 'expenditure year'. Where the Grower prepays the Planting Fee during the Initial Period, as the requirements of section 82KZMG have been met, a deduction is allowable in the income year in which the Planting Fee is prepaid for 'seasonally dependent agronomic activities'.

109. Where a Prepaid Grower **chooses** to prepay the Planting Fee in the year that the Grower commences to participate in the project, the requirements of section 82KZMG are not met and section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be subject to apportionment under section 82KZMF.

Growers who choose to pay Management Fees or Rent for a period in excess of that required by the Project's agreements

110. Although not required under the Lease and Management Agreement, a Grower participating in the Project may **choose** to prepay Management Fees or Rent for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 106 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 or prepaid Rent 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 (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.

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 in the Project of 2 Woodlots during the years ended 30 June 2002 or 30 June 2003 is unlikely to ever pass one of the tests. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in a harvest year.

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 the business activity has started to be carried on and for that, or those income years:

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and

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- 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 2 Woodlots in the Project is expected to be carrying on a business activity that will pass one of the tests, or will produce a taxation profit, for the income years ended 30 June 2014 where a Grower is a 2002 Grower, or 30 June 2015 where a Grower is a 2003 Grower or a Prepaid Grower who commences to participate in the Project in the income year ended 30 June 2002, or 30 June 2016 where a Grower is a Prepaid who commences to participate in the Project in the income year ended 30 June 2003.

122. 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 2027 for 2002 Growers who participate in a Pine/Bluegum Interest (Option A or B);
- the income year ended 30 June 2028 for Prepaid Growers who enter into the Project during the year ended 30 June 2002 and participate in a Pine/Bluegum Interest (Option A or B);
- the income year ended 30 June 2013 for 2002 Growers who participate in a Bluegum Interest;
- the income year ended 30 June 2014 for Prepaid Growers who enter into the Project during the year ended 30 June 2002 and participate in a Bluegum Interest;
- the income year ended 30 June 2028 for 2003 Growers who participate in a Pine/Bluegum Interest (Option A or B);
- the income year ended 30 June 2029 for Prepaid Growers who enter into the Project during the year ended 30 June 2003 and participate in a Pine/Bluegum Interest (Option A or B);
- the income year ended 30 June 2014 for 2003 Growers who participate in a Bluegum Interest; and
- the income year ended 30 June 2015 for Prepaid Growers who enter into the Project during the year

ended 30 June 2003 and participate in a Bluegum Interest.

The taxation profit that is projected for Growers who participate in a Pine/Bluegum Interest (Option A or B) for the income years ended 30 June 2014 and 30 June 2020 for Growers who enter into the Project during the year ended 30 June 2002, or 30 June 2015 and 30 June 2021 for Growers who enter into the Project during the year ended 30 June 2003 do not affect the period of the Commissioner's discretion as they are considered to be 'one-off' events that are specific to the afforestation industry.

123. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 60), in the manner described in the Arrangement (see paragraphs 14 to 47). 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.

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

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

Section 82KL - recouped expenditure

125. 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

126. 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).

127. The Pinetec Woodlot Project 2002 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 55 and 58 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

128. 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 Forest 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**Example 1 - Entitlement to GST input tax credits**

129. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her afforestation 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

 1 May 2002

Previous draft:

Not previously issued in draft form

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

- horticulture
- management fees expenses
- primary production
- primary production expenses
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- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
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- tax shelters
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NO: T2001/18818
ISSN: 1441 - 1172