

PR 2002/80 - Income tax: Australian Forests Project 2002

 This cover sheet is provided for information only. It does not form part of *PR 2002/80 - Income tax: Australian Forests Project 2002*

 This document has changed over time. This is a consolidated version of the ruling which was published on *5 June 2002*



Product Ruling

Income tax: Australian Forests Project 2002

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

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

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

Tax laws

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);
 - Section 25-20 (ITAA 1997);
 - Section 25-25 (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. Growers that elect to collect their own forest produce are also excluded from the class of persons to whom this Ruling applies (see paragraphs 17 and 22).

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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Date of effect

11. This Ruling applies prospectively from 5 June 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

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

Arrangement

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

- Application for Product Ruling for the Australian Forests Project 2002 dated 19 April 2002;

- **Prospectus** for the Australian Forest Project 2002 issued by Ausforestry Limited A.C.N. 055 969 429 ('Ausforestry' the 'Responsible Entity'), dated 12 March 2002;
- Draft Supplementary Prospectus for the Australian Forest Project 2002 issued by Ausforestry received in the ATO 15 May 2002;
- The **Constitution** dated 24 January 2002 establishing the Australian Forests Project 2002 ('the Constitution');
- The **Agreement to Lease** attached as Schedule 2 of the Constitution, to be entered into by each Grower and Ausforestry ('the Lessor');
- The **Management Agreement** attached as Schedule 3 of the Constitution, to be entered into by each Grower and Ausforestry ('the Project Manager');
- The **Loan Agreement** on page 11 of the Financial Package, which may be entered into by the Grower and Forest Enterprises Australia Limited A.C.N. 009 553 548 ('FEA'), an entity associated with Ausforestry;
- The Custodian Agreement between Ausforestry and Tasmanian Perpetual Trustees Limited A.C.N. 009 475 629 ('the Custodian');
- The Compliance Plan for Australian Forests Project 2002 issued by Ausforestry received in the ATO 19 April 2002;
- Correspondence (including e-mails) from the applicant's representative dated 26 April, 3 May, 7 May, 14 May 22 May, 23 May and 24 May 2002.

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

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

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the

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agreements. The effect of the agreements may be summarised as follows.

Overview

Location	Tasmania and certain areas in New South Wales and Queensland
Type of business each participant is carrying on	Commercial growing of <i>Eucalyptus nitens</i> (Shining Gum) and similar species for the purpose of thinning at approximately 9 years and clearfell at approximately 13 years.
Number of hectares under cultivation	The total projected land area, which will be planted under this prospectus, will be 3,000 hectares or 10,000 Woodlots.
Minimum allocation per Grower	One Woodlot
Size of minimum leased area	An allocation of a leased area between 0.3 to 0.5 of a hectare ('one Woodlot') sufficient to achieve a yield of 117 cubic metres per Woodlot.
Number of trees per Woodlot	Minimum of 360 trees
Expected production	Thinnings at about 9 years and clearfell at approximately 13 years
The term of the Project	13 years
Initial cost per Woodlot	\$1,606 fee for Establishment Services
Initial cost per hectare	\$5,353 fee for Establishment Services
Ongoing costs	Grower will pay ongoing Rent and Management Fees during the Term of the Project.
Other costs	<ul style="list-style-type: none"> • \$200 Loan Application fee for Growers using Forest Enterprise Australia Ltd as a finance provider. • Fee for Harvesting 3.575% of the Harvest Proceeds. • Marketing costs will be retained from the Harvest Proceeds on a proportional basis of Grower's participation. • Insurance, rates and stamp duty costs.

17. This arrangement is called the 'Australian Forests Project 2002' and is registered as a managed investment scheme under the Corporations Act. The Project is to establish, manage and harvest

Eucalyptus nitens (Shining Gum) and similar species for the purpose of woodchip.

18. Applicants will become 2002 or 2003 Growers depending on their date of application. Growers will become 2002 Growers where an application is accepted and a Lease and Management Agreement is executed by 30 June 2002. Applications of Growers processed on or after 1 July and on or before 12 April 2003 being the date in which the prospectus expires, will commence participation as 2003 Growers. Following acceptance of the application Ausforestry, the Responsible Entity, will allocate Woodlots to the Grower and register the land allocated in the Growers Register. This Ruling does not apply to Growers that elect to collect their own forest produce from their Woodlots (Electing Growers).

19. The minimum area of land that can be leased by a Grower under the Project is one Woodlot between 0.3 – 0.5 of a hectare. Growers will be allocated sufficient land to allow the production of 117 cubic metres per Woodlot over the life of the project.

20. There is no minimum amount that must be raised under the Prospectus Tasmanian Plantations Pty Ltd, a wholly owned subsidiary of FEA, has purchased the land for the Projects. Where additional land is required, Tasmanian Plantations Pty Ltd will acquire sufficient suitable land for the purposes of the Project.

21. Participating Growers will enter into a lease of land with Ausforestry. The term of the agreement is from the date of signing of the application by the Lessor, until the final clearfell of the trees upon the land.

22. The Growers will also enter into a Management Agreement with Ausforestry to have suitable Eucalyptus seedlings planted on their Woodlot for the purposes of thinning at approximately 9 years and clearfell at approximately 13 years. For a 2002 and a 2003 Grower Ausforestry will establish the Woodlot during the optimal planting season but no later than 30 April 2003. Under the Management Agreement Ausforestry will also cultivate the trees and be responsible for harvesting, processing and selling the timber. A Grower entering into the Management Agreement with Ausforestry may within six years from the commencement date elect to collect their own forest produce. Otherwise a Grower may appoint Ausforestry as its sole agent to market and sell Grower's forest produce.

23. A Custodian has been appointed under the Custodial Agreement to protect the interests of the Growers in their dealings with Ausforestry.

Constitution

24. The Constitution establishes the Project and operates as a deed binding all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Ausforestry agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 15 of the Constitution, the Responsible Entity will keep a register of Growers.

25. Under the terms of each Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall, within a reasonable time or at time of the receipt of the application money, forward the payment to the Custodian. The Responsible Entity must ensure that the Custodian deposits Application Money into an account designated as Australian Forests Project 2002 Application Fund Account. The Application Moneys will be released by the Custodian when it is reasonably satisfied that certain specified criteria in the relevant Constitution have been met (clause 13 of the Constitution).

Compliance plan

26. As required by the Corporations Law, Ausforestry Ltd has prepared a Compliance Plan. The purpose of the Compliance Plan 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.

Management Agreement

27. Under the Management Agreement, Growers contract with the Project Manager to establish and maintain a plantation of trees upon their leased area of land until maturity (after thinning at approximately nine years). At maturity, the trees will be harvested and sold on behalf of the Grower. The Project Manager will provide the Establishment Services described in clause 1 of the agreement. These include:

- The completion of all preparatory work necessary for the planting of seedlings on the land including all ploughing and vermin control deemed necessary by the Project Manager;
- The supply and planting of healthy seedlings to an average density per hectare appropriate to the soil and climatic circumstances of the land; and

- The control of weeds and other vegetation that might inhibit the growth of the seedlings on the land.

The Project Manager will complete all Establishment Services during the optimal planting season but no later than 30 April 2003.

28. The Project Manager will also provide the Management Services described in clause 3 of the agreement. These include:

- The replanting of any seedlings which die during the first year after planting, to 90% of the average initial planting density, where such death is caused by planting technique or vermin destruction;
- The general maintenance of the plantation including control of weeds, suckers, vermin or other pests which may impede the growth of the seedlings;
- The maintenance in good condition and repair of all fire breaks and access roads in and about the Land;
- The application of fertiliser to the land in such form and in such quantities as to maintain satisfactory growth;
- The provision of a written report in relation to the progress of the plantation to the Grower annually; and
- The provision of advice and assistance to the Grower generally in relation to the thinning and pruning of the plantation and the general management thereof in accordance with the best practices of the forestry industry.

29. The Project Manager will provide the services of Harvesting and Marketing the trees, which involves the Project Manager determining the appropriate time for the thinning and clearfelling of trees on the land, and the marketing and selling of the trees which have been grown on the land, on behalf of the Grower.

Agreement to Lease

30. Growers enter into an Agreement to Lease with the Lessor that, upon identification and allocation of the specified area of land to the Grower, becomes a Lease Agreement. This Lease Agreement is for the lease of a specified area of land upon which their plantation will be established.

31. Under this agreement the Grower agrees to pay to the Lessor the specified Rent for the lease of the specified area of land for the term of the lease period. The term of the agreement is from the date of signing of the application by the Lessor, until the final clear fell of the

trees upon the land. This agreement shall operate as an agreement to lease until the allocation of the land, and upon allocation, shall operate as a deed of lease giving the Grower an interest in the specified area of land for the balance of the term.

Fees

32. For applications lodged on or before 30 June 2002, a Grower will pay the following fees per Woodlot under the Management and Agreement to Lease:

- An initial fee for Establishment Services of \$1,606 per Woodlot is payable for services provided in the period ending 30 April 2003;
- Annual Rent of \$77 per Woodlot payable in arrears on 30 June 2003 and each year thereafter for the Term of the Project (CPI indexed after 30 June 2003);
- An annual Management Fee of \$55 per Woodlot payable in arrears on 30 June 2003 and each year thereafter for the term of the Project (CPI indexed after 30 June 2003);
- A fee for Harvesting of 3.575% of the Harvest Proceeds received by the Grower, payable by retention from the Harvest Proceeds;
- Marketing costs will be retained from the Harvest Proceeds on a proportional basis of Grower's participation; and
- In addition to the above, Growers will be invoiced for any legal costs, stamp duty and insurance in relation to their participation, and for the portion of land taxes represented by the value attributed to their standing trees.

33. For applications lodged after 30 June 2002 and on or before 12 April 2003, a Grower will pay the following fees per Woodlot under the Management and Agreement to Lease:

- An initial fee for Establishment Services of \$1,606 per Woodlot is payable on application for services during the optimal planting season but no later than 30 April 2003;
- Annual Rent of \$77 per Woodlot payable in arrears on 30 June 2003 and each year thereafter for the term of the Project (CPI indexed after 30 June 2003);

- An annual Management Fee of \$55 per Woodlot payable in arrears on 30 June 2003 and each year thereafter for the term of the Project (CPI indexed after 30 June 2003);
- A fee for Harvesting of 3.575% of the Harvest Proceeds received by the Grower, payable by retention from the Harvest Proceeds;
- Marketing costs will be retained from the Harvest Proceeds on a proportional basis of Grower's participation; and
- In addition to the above, Growers will be invoiced for any legal costs, stamp duty and insurance in relation to their investment, and for the portion of land taxes represented by the value attributed to their standing trees.

Finance

34. Growers can fund their involvement in the Project by borrowing from Forest Enterprise Australia Ltd (a lender associated with the Responsible Entity), or borrow from an independent lender.

35. Growers are able to borrow from Forest Enterprises Australia Ltd an amount equal to their full application fee less a deposit of \$200 per Woodlot. Standard terms for the finance is, as follows:

- One year interest free – repayable by 12 monthly instalments;
- Two years at fixed interest of 8.95% p.a. – repayable by 24 monthly instalments;
- Three years at fixed interest of 9.95% p.a. – repayable by 36 monthly instalments; and
- Four years at fixed interest of 10.95% p.a. – repayable by 48 monthly instalments.

Principal and interest loans of up to 10 years may be negotiated by FEA at fixed interest of 10.95% pa payable by monthly instalments.

36. The security for the loan is provided by the assignment to Forest Enterprise Australia Ltd of the Grower's rights and interest in the Management Agreement and the trees planted under it, and every other document, interest or right held in connection with the cultivation of the trees, including the Agreement to Lease.

37. The loan is provided by Forest Enterprise Australia Ltd on a full recourse basis and recovery action will be taken in respect of any default by the borrower.

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38. A Loan Application fee of \$200 is payable on applying for a loan. Overdue repayments will incur interest at the default rate of 15% per annum.

39. 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 other than Forest Enterprise Australia Ltd are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

40. This Ruling applies only to Growers who are accepted to participate:

- On or before 30 June 2002, where the Grower has executed a Lease and Management Agreement on or before that date (a '2002 Grower'); and/or
- On or after 1 July 2002 and before the expiry date of this Prospectus, such date being no later than 12 April 2003, where the Grower has executed a Lease

and Management Agreement on or between those dates (a '2003 Grower').

41. The Grower's participation in the Project must constitute the carrying on of a business of primary production (see explanations at paragraphs 55 to 68). 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 that elect to market timber produce from their Woodlots (Electing Growers).

The Simplified Tax System ('STS')

Division 328

42. 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

43. 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

44. 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.

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

PR 2002/80**Deductions for Management Fees, Rent, Interest, insurance, land tax, rates, stamp duty on lease and borrowing costs.****Sections 8-1, 25-20 and section 25-25**

46. A Grower who is not an 'STS taxpayer' may claim, on a per Woodlot basis, tax deductions for the following expenses:

2002 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Establishment Service Fee	8-1	\$1,606 See Notes (i) & (ii) (below)		
Management Fee	8-1		\$55 – See Notes (i) & (iii) (below)	\$55 – See Notes (i) & (iii) (below)
Rent	8-1		\$77 – See Notes (i) & (iii) (below)	\$77 – See Notes (i) & (iii) (below)
Interest on loans with FEA Ltd	8-1	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)
Insurance, land tax and rates	8-1	As incurred See Note (v) (below)	As incurred See Note (v) (below)	As incurred See Note (v) (below)
Stamp duty on lease	25-20	As incurred See Note (vi) below	nil	nil
Borrowing costs	25-25	Must be calculated – see note (vii) below	Must be calculated – see note (vii) below	Must be calculated – see note (vii) below

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Establishment Service Fee	8-1	\$1,606 See Notes (i) & (ii) below		
Management Fee	8-1	\$55 – See Notes (i) & (iii) below	\$55 – See Notes (i) & (iii) below	\$55 – See Notes (i) & (iii) below
Rent	8-1	\$77 – See Notes (i) & (iii) below	\$77 – See Notes (i) & (iii) below	\$77 – See Notes (i) & (iii) below
Interest on loans with FEA Ltd	8-1	As incurred See Note (iv) below	As incurred See Note (iv) below	As incurred See Note (iv) below
Insurance, land tax and rates	8-1	As incurred See Note (v) below	As incurred See Note	As incurred See Note
Stamp duty on lease	25-20	As incurred – see note (vi) below	nil	nil
Borrowing costs	25-25	Must be calculated – see note (vii) below	Must be calculated – see note (vii) below	Must be calculated – see note (vii) 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 121.
- (ii) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is incurred.
- (iii) Where a Grower who is not an ‘STS taxpayer’, pays the Management Fee and Rent in the relevant income years shown in the Management Agreement and the Agreement to Lease, those fees are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (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 79 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.

- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Forest Enterprise Australia 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 than Forest Enterprise Australia Ltd, should read the discussion of the prepayment rules in paragraphs 73 to 85 (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.
- (v) The insurance, land tax and rates associated with the afforestation activities relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income is to be gained from this business. They will thus be deductible under the first limb of section 8-1.
- (vi) The stamp duty incurred in relation to the Agreement to Lease is deductible under section 25-20. The expenditure is incurred in preparing, registering or stamping a lease over property used solely for the purpose of producing assessable income.
- (vii) The Loan Application fee is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter.

Tax outcomes for Growers who are ‘STS taxpayers’**Assessable Income****Section 6-5 and section 328-105**

47. 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.

48. 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 Management Fees, Rent, Interest, insurance, land tax, rates, stamp duty on lease and borrowing costs**Sections 8-1, 25-20, 25-25 and section 328-105**

49. A Grower who is an ‘STS taxpayer’ may claim, on a per Woodlot basis, tax deductions for the following expenses. If an amount of expenditure is not fully paid in the year shown in the table below, it is only deductible to the extent that it is paid:

2002 Growers

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Establishment Service Fee	8-1 328-105	\$1606 See Notes (viii) & (ix) below		
Managements Fee	8-1 328-105		\$55 – See Notes (viii) & (x) below	\$55 – See Notes (viii) & (x) below
Rent	8-1 328-105		\$77 – See Notes (viii) & (x) below	\$77 – See Notes (viii) & (x) below
Interest on loans with FEA Ltd	8-1 328-105	As incurred See Note (xi) below	As incurred See Note (xi) below	As incurred See Note (xi) below
Insurance, Land Tax and Rates	8-1	As incurred See Note (xii) below	As incurred See Note (xii) below	As incurred See Note (xii) below
Stamp Duty on lease	25-20	As incurred See Note (xiii) below	nil	nil

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Borrowing Costs	25-25	Must be calculated See Note (xiv) below	Must be calculated See Note (xiv) below	Must be calculated See Note (xiv) below
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2003 Growers

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Establishment Service Fee	8-1 328-105	\$1606 See Notes (vii) & (viii) below		
Management Fee	8-1 328-105	\$55 – See Notes (vii) & (ix) below	\$55 – See Notes (vi) & (ix) below	\$55 – See Notes (vi) & (ix) below
Rent	8-1 328-105	\$77 – See Notes (vii) & (ix) below	\$77 – See Notes (vii) & (ix) below	\$77 – See Notes (vii) & (ix) below
Interest on loans with FEA Ltd	8-1 328-105	As incurred See Note (x) below	As incurred See Note (x) below	As incurred See Note (x) below
Insurance, Land Tax and Rates	8-1 328-105	As incurred See Note (xi) below	As incurred See Note (xi) below	As incurred See Note (xi) below
Stamp Duty on lease	25-20	As incurred See Note (xii) below	nil	nil
Borrowing Costs	25-25	Must be calculated See Note (xiv) below	Must be calculated See Note (xiv) below	Must be calculated See Note (xiv) below

Notes:

- (viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits). See Example at paragraph 121.
- (ix) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is incurred.
- (x) Where a Grower who is an ‘STS taxpayer’, pays the Management Fee and Rent in the relevant income years

shown in the Management Agreement and the Agreement to Lease, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 73 to 85). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 79, 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) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Forest Enterprise Australia 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 than Forest Enterprise Australia Ltd, should read the discussion of the prepayment rules in paragraphs 73 to 85 (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
- (xii) The insurance, land tax and rates associated with the afforestation activities relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income is to be gained from this business. They will thus be deductible under the first limb of section 8-1.
- (xiii) The stamp duty incurred in relation to the Agreement to Lease is deductible under section 25-20. The expenditure is incurred in preparing, registering or stamping a lease over property used solely for the purpose of producing assessable income.
- (xiv) The Loan Application fee is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter.

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner’s discretion

50. For a Grower who is an individual and who enters into the Project as a 2002 Grower or a 2003 Grower the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. For both 2002 and 2003 Non-Electing Growers, under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2014 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.

51. 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 107 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)).

52. 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.

53. 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

54. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Agreement to Lease 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?

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

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

57. For schemes such as that of the Australian Forests 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.

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

- The Grower has an identifiable interest (by lease) in the land on which the Grower's trees are established;
- The Grower has a right to harvest and sell the wood produce from those trees;
- The afforestation activities are carried out on the Grower's behalf;
- The afforestation activities of the Grower are typical of those associated with a afforestation business; and

- The weight and influence of general indicators point to the carrying on of a business.

59. In this Project, each Grower enters into a Management Agreement and the Agreement to Lease.

60. Under the Agreement to Lease each individual Grower will have rights over a specific and identifiable area of between 0.3 to 0.5 hectares of land. The Agreement to Lease provides the Grower with an ongoing interest in the specific trees on the area for the term of the Project. Under the Agreement to Lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Agreement to Lease allows the Project Manager come onto the land to carry out its obligations under the Management Agreement.

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

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

63. 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.

64. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the wood produce that will return a before-tax profit, i.e. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

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

67. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act*, is sufficient. During the term of the Project, the

Manager will provide the Grower with regular progress reports on the Grower's Woodlot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

68. 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 Australian Forest Project 2002 Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

69. 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.

70. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Management Fees and Rent

Section 8-1

71. Consideration of whether the initial fee for Establishment Services 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.

72. The 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 wood produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Management Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMG

73. 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.

74. 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

75. 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)).

76. 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.

77. 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 Forest Enterprise Australia 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.

78. 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.

79. 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.

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

80. 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

81. 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).

82. 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.

83. 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.

84. 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.

85. 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

86. Under the Management Agreement, a Grower incurs a Year 1 fee for Establishment Services consisting of expenditure of \$1606 for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year the expenditure is incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

87. The Management Agreement also requires that a Grower incurs a Management Fee of \$55 per year for the performance of management services during the term of the Project. Under the Agreement to Lease a Grower incurs Rent of \$77 to lease land during the term of the Project.

88. The Management Fee incurred under the Management Agreement and the Rent incurred under the Agreement to Lease are not prepaid. These fees are charged for providing management services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred.

89. 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 Management Fees and the Rent.

90. 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*

91. Although not required under either the Management Agreement, the Agreement to Lease, or the Loan Agreement with Forest Enterprise Australia Ltd. (see below), a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 89 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

93. 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

Section 8-1

(i) Growers who use Forest Enterprise Australia Ltd as the finance provider

94. Some Growers may finance their participation in the Project through a loan facility with Forest Enterprise Australia Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Rent and Management Fees.

95. The interest incurred for the year ended 30 June 2002 or 30 June 2003, for 2002 and 2003 Growers respectively, and in subsequent years of income, will be in respect of a loan to finance the Grower's business operations - the cultivation and growing trees and the lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

96. As with the Management Fees and the Rent, in the absence of any application of the prepayment provisions (see paragraphs 73 to 85), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

98. 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 Forest Enterprise Australia Ltd as the finance provider

99. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Forest Enterprise Australia 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.

100. 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 73 to 85).

Deductibility of lease document expenses

Section 25-20

101. A Grower will pay stamp duty in relation to the Agreement to Lease. Section 25-20 of the ITAA 1997 provides that a Grower can deduct expenditure incurred in preparing, registering or stamping a lease over property used solely for the purpose of producing assessable income.

102. The \$20 stamp duty on the stamping of the Agreement to Lease is deductible by virtue of s25-20 of the ITAA 1997 given that:

- The expenditure is incurred upon stamping of the lease over a Grower's Woodlot; and
- The property leased is to be used by the Grower to derive assessable income through the harvest of the trees to be planted on the property.

Deductibility of borrowing expenses

Section 25-25

103. Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or are to be used during that income

year for income producing purposes. The expenses are deductible over the period of the loan specified in the loan agreement, or five years, whichever is the shorter period, beginning with the year in which they were incurred (subsections 25-25(4) and (5)). Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

Deferral of losses from non-commercial business activities

Division 35

104. 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.

105. 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.

106. 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.

107. 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.

108. 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).

109. 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-Electing Grower who acquires the minimum allocation of one Woodlot in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2015. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

110. Therefore, 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.

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

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

112. Information provided with this Product Ruling indicates that a Non-Electing 2002 and a Non-Electing 2003 Grower who acquires the minimum investment of 1 Woodlot in the Project is expected to be carrying on a business activity that will produce a taxation profit, for the income years ended 30 June 2015.

113. 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 2014.

114. The taxation profit that is projected for the income year ended 30 June 2011 for a 2002 Grower and a 2003 Grower does not affect the period of the Commissioner's discretion as it is considered to be a 'one-off' event that is specific to the afforestation industry.

115. 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 50), in the manner described in the Arrangement (see paragraphs 14 to 39). 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.

116. 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;
- 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

117. 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

118. 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).

119. The Australian Forest 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 46 and 49 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.

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

Example

Example - Entitlement to GST input tax credits

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

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

*Taxable supply

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

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4000 (not \$4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2000 only, not one tenth of \$2200).

Detailed contents list

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

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