



# ***PR 2002/81 - Income tax: Forestry Bond 2002 - Supplementary Prospectus***

 This cover sheet is provided for information only. It does not form part of *PR 2002/81 - Income tax: Forestry Bond 2002 - Supplementary Prospectus*

 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: Forestry Bond 2002 – Supplementary Prospectus

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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**, **Previous Rulings**, **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**

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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**

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

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

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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 'Forestry Bond 2002 – Supplementary Prospectus' 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);
  - 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 1997); 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.

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.

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## Date of effect

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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

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the 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.

## Previous Rulings

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14. This Ruling replaces Product Ruling PR 2002/33 which is withdrawn on and from the date this Ruling is made (5 June 2002). Product Ruling PR 2002/33 will continue to apply to participants who entered into the Project on or before 5 June 2002.

## Arrangement

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

- Application for Product Ruling dated 23 January 2002;
- Forestry Bond 2002 Prospectus dated 22 March 2002;

- Forestry Bond 2002 Draft Supplementary Prospectus, undated;
- Constitution for Forestry Bond 2002, undated;
- **Forestry Management Agreement – Eucalyptus, for Forestry Bond 2002 between Australian Blue Gum Management Ltd [‘Responsible Entity’ and ‘Grantor’] and the Grower, undated;**
- **Forestry Management Agreement – Teak, for Forestry Bond 2002 between Australian Blue Gum Management Ltd [‘Responsible Entity’ and Grantor’] and the Grower, undated;**
- Compliance Plan for Forestry Bond 2002, undated; and
- Additional correspondence dated 14 February 2002, 11 March 2002, 13 March 2002, 27 March 2002, 8 May 2002 and 21 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.**

16. 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.

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

### Overview

18. This arrangement is called Forestry Bond 2002 – Supplementary Prospectus.

|  |  |
|--|--|
| Location   | South West region of Western Australia, the Green Triangle region of South East Australia and Western Victoria, North Queensland and Tasmania  |
| Type of business each participant is carrying on | Commercial growing, and cultivation of <i>Tectona grandis</i> (Teak) trees for the purpose of producing timber for veneer and timber products. |

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|                                      |  |
|--------------------------------------|--|
|                                      | Commercial growing and cultivation of <i>Eucalyptus globulus</i> (Tasmanian blue gum) and <i>Eucalyptus nitens</i> (Shining gum) for the purpose of producing timber for woodchipping and timber products. |
| Number of hectares under cultivation | 1,100  |
| Size of each Leased Area             | Each Timberlot consists of a Teak Lot which is 0.75 hectares in size and a Eucalyptus Lot which is approximately 1 hectare in size.  |
| Number of trees per hectare          | 800 – 1,300 trees  |
| The term of the investment           | 15 years   |
| Initial cost                         | \$11,522.50  |
| Initial cost per hectare             | \$10,743 – Teak<br>\$3,465 – Eucalyptus  |
| Ongoing costs                        | Management fees and rent.  |

19. The Project Land is located in the South West region of Western Australia, the Green Triangle region of South-East South Australia and Western Victoria, North Queensland and Tasmania. Australian Blue Gum Management Ltd will obtain interests in the land in the form of leasehold (in South Australia, Victoria and Western Australia), profit a'prendre and licence (in Queensland) or forestry rights (in New South Wales and Tasmania) and will grant a 'Teak Interest' and 'Eucalypt Interest' to the Grower. Eucalypt Interests will consist of either a sub-lease (for land in South Australia, Victoria and Western Australia) or a lease of or equivalent rights of a Grantee of a forestry right (for land located in New South Wales and Tasmania). Teak Interests will consist of a lease of a profit a'prendre (for land located in Queensland).

20. Growers participating in the Project will enter into a Forestry Management Agreement – Teak, and a Forestry Management Agreement – Eucalyptus (defined as 'Forestry Management Agreements' for the purposes of this Ruling unless cited individually). Australian Blue Gum Management Ltd will grant a Teak Interest and Eucalypt Interest (defined as 'Timberlot Interests' for the purposes of this Ruling unless cited individually) to the Grower to enable the Grower to carry on the business afforestation for the commercial

production of timber produce. Under the Forestry Management Agreements Growers are granted Timberlot Interests for areas of land called a 'Teak Lot' and an 'Eucalypt Lot' for a term of 15 years and 11 years respectively. Each Teak Lot is 0.75 hectares in size and each Eucalypt Lot is approximately 1 hectare. For the purposes of this Ruling 'Teak Lot(s)' and 'Eucalypt Lot(s)' will be referred to as 'Timberlots' unless cited individually.

21. Under this offer, Growers may enter the Project in either the 2001/2002 income year (defined as '2002 Growers' for the purposes of this Ruling) or the 2002/2003 income year ('2003 Growers'). Participants whose applications are received and executed on or before 30 June 2002 will participate in the Project as 2002 Growers. Applications received after 30 June 2002 will be executed on or after 1 July 2002 and applicants will participate in the Project as 2003 Growers.

22. Under the Forestry Management Agreements, Growers appoint Australian Blue Gum Ltd as Responsible Entity to manage their Timberlot. The Responsible Entity will be responsible for establishment, cultivation and harvest of the trees. Growers may elect to take delivery of and market their own timber produce (referred to as 'Non-participating Growers') or the Responsible Entity will do so on their behalf.

23. Each Grower must apply for a minimum of one Timberlot, at a cost (per Timberlot) of \$11,522.50. There is no minimum subscription for the Project. Upon application, Growers will execute a Power of Attorney enabling the Responsible Entity, Australian Blue Gum Management Ltd, to act on their behalf as required.

### **Constitution**

24. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity, Australian Blue Gum Management Ltd agrees to act for the Grower and to manage the Project. The Responsible Entity will keep a register of Growers (cl. 18). The Forestry Management Agreements are 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 Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

### **Compliance Plan**

25. Australian Blue Gum Management Ltd has prepared a Compliance Plan as required by the Corporations Act 2001. Its purpose is to ensure that the Responsible Entity manages the Project

in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

## Interest in land

26. Timberlot Interests are granted by Australian Blue Gum Management, to the Grower under the terms of the Forestry Management Agreements (cl. 3.3 of each Agreement). Growers are granted an interest in land in the form of Timberlot Interests to use their Timberlot(s) for carrying on the business of a long term commercial afforestation project (cl. 3.3 of each Agreement). Growers must pay rent annually to the Grantor. The term of a Grower's Eucalypt Interest is 11 years from the date on which the last planting service is performed in relation the Project. The term of a Grower's Teak Interest is 15 years from the date on which the last planting service is performed in relation the Project.

## Forestry Management Agreements

27. Each Grower enters into Forestry Management Agreements with the Responsible Entity for each Timberlot. The expiration date of the Project will be no earlier than 31 December 2017.

28. Growers contract with the Responsible Entity to maintain, supervise and manage, in accordance with good silvicultural practice, the trees and afforestation activities to be carried on by the Grower on the Timberlot. Growers pay a Plantation Establishment Expense for each Timberlot on subscription and an annual management fee and rent for each year thereafter.

29. The Responsible Entity will perform the following services during the twelve month period following the commencement date:

- ensure control of all weeds and vermin on the Timberlot (s);
- cultivate the Timberlot(s) in the manner specified in the Plantation Management Plan;
- procure sufficient seedlings to the specifications recommended in the Plantation Management Plan;
- plant *Tectona grandis* (Teak), *Eucalyptus globulus* (Tasmanian blue gum) and *Eucalyptus nitens* (Shining gum) on the Timberlot(s); and
- supervise and secure management of all works on the Timberlot(s).

30. The Responsible Entity will perform the following ongoing services under this Agreement:

- manage the Timberlot(s) in accordance with good silvicultural practice;
- use all reasonable measures to exterminate and keep the Timberlot(s) free from rabbits and other vermin;
- make applications of fertiliser during the term of the Project in accordance with good silvicultural practice;
- use all reasonable measures to keep the Timberlot free from vermin, noxious weeds, pests and diseases;
- undertake thinning on the Teak Lot(s); and
- harvest the tress grown on the Timberlot(s) and for 'Participating Growers' enter into purchase agreements for the sale of the timber produce.

31. Growers may elect to take delivery of the timber produce harvested from their Timberlot(s) upon application (cl.10.1(a) of each Agreement). However, where Growers do not elect (referred to as 'Participating Growers'), the Responsible Entity will sell the timber produce from the Timberlots on the Grower's behalf at such a price which is the best interests of the Grower (cl. 10.4(b) of each Agreement).

32. The Responsible Entity may arrange insurance for the Grower's trees on the Growers behalf. If the Grower chooses to insure their trees and the Responsible Entity pays any premiums under the insurance policy, the Grower must reimburse the Responsible Entity the amount of the premium (cl.5.8(2) of each Agreement). The Responsible Entity will charge the Grower an administration fee for arranging the insurance (cl. 5.8(a)(3) of each Agreement).

### **Fees**

33. The initial fee payable under the Forestry Management Agreements is \$11,522.50 per Timberlot payable on application. This includes a plantation establishment expense of \$8,057.50 under the Forestry Management Agreement – Teak, and a plantation establishment expense of \$3,465 under the Forestry Management Agreement – Eucalyptus. For 2002 Growers and 2003 Growers, these services will be completed within the twelve month period following the commencement date.

34. Under the Forestry Management Agreements, annual management fees per Timberlot of \$165 are payable by 31 October for each year for the term of each Agreement, commencing on 31 October 2002 for 2002 Growers, or 31 October 2003 for 2003 Growers. This fee consists of \$82.50 for management fees under the Forestry Management Agreement – Teak and \$82.50 for management

fees under the Forestry Management Agreement – Eucalypt. These amounts are to be indexed by the increase in the Consumer Price Index for the 12 months ending on 30 September in the Financial Year in which the management fee is charged. The indexation will commence in the year ended 30 June 2004 for 2002 Growers, or the year ended 30 June 2005 for 2003 Growers.

35. Under the Forestry Management Agreements, rent of \$495 per Timberlot is payable annually by 31 October for each year for the term of the Agreement commencing on 31 October 2002 for 2002 Growers, or 31 October 2003 for 2003 Growers. This consists of \$247.50 for rent under the Forestry Management Agreement – Teak and \$247.50 for rent under the Forestry Management Agreement – Eucalypt. These amounts are to be indexed by the increase in the Consumer Price Index for the 12 months ending on 30 September in the Financial Year in which the rent is charged. This indexation will commence in the year ended 30 June 2004 for 2002 Growers, or the year ended 30 June 2005 for 2003 Growers.

36. A pruning and thinning fee of \$247.50 per Teak Lot is payable under the Forestry Management Agreement – Teak. This fee is payable for each pruning or thinning carried out and is payable by 31 October of the financial year in which the pruning or thinning is carried out. There is no pruning or thinning fee payable under the Forestry Management Agreement – Eucalyptus.

37. Under the Forestry Management Agreements, a harvesting and marketing fee is payable to the Responsible Entity in respect of thinnings and clear fellings. The amount of the fee is 2.75% of the Gross Sales Proceeds retained by the Responsible Entity in the Proceeds Fund for Participating Growers. For Non-Participating Growers, the amount of the fee is 2.75% of the Non-Participating Grower's net proceeds of sale. Net proceeds of sale for Non-Participating Growers are the Non-Participating Grower's gross sale proceeds less that Grower's costs or expenses (if any) incurred in relation to clear felling, logging, processing, insurance, marketing, loading and transportation of the timber produce.

38. A performance bonus is payable to the Responsible Entity under the Forestry Management Agreements. Under the Forestry Management Agreement – Teak, the amount is 22% of Net Harvest Proceeds in excess of \$52,567 per Teak Lot. Under the Forestry Management Agreement – Eucalyptus, the amount is 22% of Net Harvest Proceeds in excess of \$9,019 per Eucalypt Lot.

39. In respect of both Agreements, for Participating Growers, Net Harvest Proceeds is equal to the Participating Grower's Proportional Interest in the Gross Sale Proceeds, less

- that Grower's unpaid rent;

- that Grower's unpaid management fee;
- that Grower's unpaid planting expense; and
- an amount equal to that Grower's Proportional Interest in any costs or expenses incurred by the Responsible Entity in relation to thinning or clear felling (as the case may be), logging, processing, insurance, marketing, loading and transportation of the timber produce.

40. In respect of both Agreements, Net Harvest Proceeds for Non-Participating Growers is equal to the Gross Proceeds of sale (and any amount of insurance proceeds or compensation received) less the Responsible Entity's estimate of :

- the Grower's unpaid rent;
- costs of thinning or clear felling, as the case may be, transporting and placing the Grower's timber on the area of the Plantation as determined by the responsible Entity;
- the unpaid management fee;
- any unpaid planting expense; and
- any other amount payable to the Grantor or Responsible Entity.

### **Planting, Cultivation and Harvesting**

41. The Responsible Entity will supervise and manage all commercial silviculture activities to be carried on by the Grower on their Timberlot(s). The ongoing services to be performed by the Responsible Entity are listed in Schedule 2 to the Forestry Management Agreements.

42. The Responsible Entity will procure sufficient seedlings, plant the seedlings and supervise and secure management of all planting works on each Timberlot. For 2002 Growers and 2003 Growers, these services will be completed in the twelve month period following the commencement date. The Responsible Entity will replace sufficient seedlings on each Timberlot 12 months after planting to ensure a survival rate of 90% of trees planted (cl.5.2(a)).

43. The Responsible Entity will perform non-commercial pruning and thinning on each Teak Lot. Pruning is expected to take place during the years ended 30 June 2006 and 30 June 2008. Thinning is expected to take place during the year ended 30 June 2007. A commercial thinning of each Teak Lot is expected to occur in approximately the year ended 30 June 2012. No pruning or thinning will be performed on the Eucalyptus Lots.

44. The Responsible Entity will clear fell the Grower's Tree Crop in accordance with the Plantation Management Plan. For Participating Growers the Responsible Entity will use reasonable endeavours to arrange the sale of the timber produce and enter into a purchase agreement pursuant to which the Gross Sale Proceeds will be paid into the Proceeds Fund. For Non-Participating Growers, the timber produce will be placed on an area of the Plantation as determined by the Responsible Entity.

45. Proceeds received by the Responsible Entity are to be distributed to Participating Growers according to each Grower's proportional interest in the Proceeds fund after deducting the following:

- any amount due to the Responsible Entity or Grantor under a Forestry Management Agreement; and
- any other amount due to the Responsible Entity or an associated entity of the Responsible Entity.

## Finance

46. Growers can fund their investment 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**

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### **Application of this Ruling**

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

- on or before 30 June 2002 and who have executed Forestry Management Agreements before that date (2002 Growers); and/or
- on or after 1 July 2002 and before the expiry date of the Prospectus, but in any case, before 30 June 2003 and where the Grower has executed Forestry Management Agreements on or between those dates (2003 Growers).

49. The Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to those Growers who make an election under either Forestry Management Agreement to take delivery of and market the timber produced from their Timberlot(s).

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

#### **Division 328**

50. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, 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**

51. 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 '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**

52. 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.

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

#### **Deductions for the Plantation Establishment Expense, Management Fees and Rent**

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

54. A Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

##### **2002 Growers**

| <b>Fee Type</b>                         | <b>ITAA 1997 Section</b> | <b>Year ended 30/6/2002</b>                   | <b>Year ended 30/6/2003</b>             | <b>Year ended 30/6/2004</b>                        | <b>Year ended 30/6/2005</b>                        |
|---|--------------------------|---|---|--|--|
| <b>Plantation Establishment Expense</b> | 8-1                      | \$11,522.50<br>– See Notes (i) & (ii) (below) |   |  |  |
| <b>Management Fee</b>                   | 8-1                      |   | \$165<br>– See Notes (i) & (ii) (below) | \$165 (indexed)<br>– See Notes (i) & (iii) (below) | \$165 (indexed)<br>– See Notes (i) & (iii) (below) |
| <b>Rent</b>                             | 8-1                      |   | \$495<br>– See Notes (i) & (ii) (below) | \$495 (indexed)<br>– See Notes (i) & (iii) (below) | \$495 (indexed)<br>– See Notes (i) & (iii) (below) |

**2003 Growers**

| <b>Fee Type</b>                                 | <b>ITAA<br/>1997<br/>Section</b> | <b>Year<br/>ended<br/>30/6/2003</b>                 | <b>Year<br/>ended<br/>30/6/2004</b>            | <b>Year<br/>ended<br/>30/6/2005</b>                         |
|---|----------------------------------|---|--|---|
| <b>Plantation<br/>Establishment<br/>Expense</b> | 8-1                              | \$11,522.50<br>– See Notes<br>(i) & (ii)<br>(below) |  |   |
| <b>Management<br/>Fee</b>                       | 8-1                              |   | \$165<br>– See Notes<br>(i) & (iii)<br>(below) | \$165<br>(indexed)<br>– See Notes<br>(i) & (iii)<br>(below) |
| <b>Rent</b>                                     | 8-1                              |   | \$495<br>– See Notes<br>(i) & (iii)<br>(below) | \$495<br>(indexed)<br>– See Notes<br>(i) & (iii)<br>(below) |

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 119.
- (ii) Expenditure for ‘seasonally dependant agronomic activities’ is deductible in the income year in which it is incurred.
- (iii) The management fees and rent shown in the Forestry Management Agreements 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 87 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**

55. 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.

56. 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 Plantation Establishment Expense, Management fees and Rent****Section 8-1 and section 328-105**

57. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

**2002 Growers**

| <b>Fee Type</b>                                 | <b>ITAA<br/>1997<br/>Sections</b> | <b>Year<br/>ended<br/>30/6/2002</b>                       | <b>Year<br/>ended<br/>30/6/2003</b>                         | <b>Year<br/>ended<br/>30/6/2004</b>                                   | <b>Year<br/>ended<br/>30/6/2005</b>                                  |
|---|-----------------------------------|---|---|---|--|
| <b>Plantation<br/>Establishment<br/>Expense</b> | 8-1<br>&<br>328-105               | \$11,522.50<br>– See Notes<br>(iv), (v) &<br>(vi) (below) |   |   |  |
| <b>Management<br/>Fee</b>                       | 8-1<br>&<br>328-105               |   | \$165<br><br>– See<br>Notes (iv),<br>(v) & (vii)<br>(below) | \$165<br>(indexed) –<br>See Notes<br>(iv), (v) &<br>(vii)<br>(below)  | \$165<br>(indexed) –<br>See Notes<br>(iv), (v) &<br>(vii)<br>(below) |
| <b>Rent</b>                                     | 8-1<br>&<br>328-105               |   | \$495<br><br>– See<br>Notes (iv),<br>(v) & (vii)<br>(below) | \$495<br>(indexed)<br>– See<br>Notes (iv),<br>(vi) & (vii)<br>(below) | \$495<br>(indexed)<br>– See<br>Notes (iv),<br>(v) & (vii)<br>(below) |

**2003 Growers**

| <b>Fee Type</b>                                 | <b>ITAA<br/>1997<br/>Section</b> | <b>Year<br/>ended<br/>30/6/2003</b>                       | <b>Year<br/>ended<br/>30/6/2004</b>                  | <b>Year<br/>ended<br/>30/6/2005</b>                               |
|---|----------------------------------|---|--|---|
| <b>Plantation<br/>Establishment<br/>Expense</b> | 8-1<br>&<br>328-105              | \$11,522.50<br>– See Notes<br>(iv), (v) &<br>(vi) (below) |  |   |
| <b>Management<br/>Fee</b>                       | 8-1<br>&<br>328-105              |   | \$165<br>– See Notes<br>(iv), (v) &<br>(vii) (below) | \$165<br>(indexed)<br>– See Notes<br>(iv), (v) &<br>(vii) (below) |
| <b>Rent</b>                                     | 8-1<br>&<br>328-105              |   | \$495<br>– See Notes<br>(iv), (v) &<br>(vii) (below) | \$495<br>(indexed)<br>– See Notes<br>(iv), (v) &<br>(vii) (below) |

**Notes:**

- (iv) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 119.
- (v) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.
- (vi) Expenditure for 'seasonally dependant agronomic activities' is deductible in the income year in which it is incurred.
- (vii) Where a Grower who is an 'STS taxpayer', pays the management fees and the rent in the relevant income years shown in the Forestry Management Agreements, 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 83 to 102). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 87, 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**

58. 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 should read the discussion of the prepayment rules in paragraphs 83 to 102 (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**

59. For a Grower who is an individual and who enters the Project during the years ended 30 June 2002 or 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2016 for 2002 Growers and 30 June 2003 to 30 June 2017 for 2003 Growers 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.

60. 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 106 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

- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

61. 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.

62. 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 35-5(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**

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

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

## **Explanations**

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### **Is the Grower carrying on a business?**

64. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in Forestry Bond 2002 – Supplementary Prospectus must amount to the carrying on of a business of primary production.

65. 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.

66. For schemes such as that of Forestry Bond 2002 – Supplementary Prospectus, 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, (1984) 15 ATR 932.

67. 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 timber 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.

68. In this Project, each Grower enters into Forestry Management Agreements. Under the Forestry Management Agreements each individual Grower will have rights over a specific and identifiable area of 1.75 hectares of land. The Forestry Management Agreements provide the Grower with an ongoing interest in the specific trees on the Timberlot(s). Under the Timberlot Interests the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Timberlot Interests allow the Responsible Entity to come onto the land to carry out its obligations under the Forestry Management Agreements.

69. Under the Forestry Management Agreements the Responsible Entity is engaged by the Grower to establish and maintain a Timberlot 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 Timberlot on the Grower's behalf.

70. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's

Timberlot unless the Grower is a Non-Participating Grower under the Forest Management Agreements.

71. 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.

72. 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 timber 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.

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

74. 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 Timberlot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

75. The Grower's degree of control over the Responsible Entity as evidenced by the Forestry Management Agreements, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Timberlot 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.

76. 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 Forestry Bond 2002 – Supplementary Prospectus will constitute the carrying on of a business.

## **The Simplified Tax System**

### **Division 328**

77. 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.

78. 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 the plantation establishment expense, management fees and rent**

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

79. Consideration of whether the plantation establishment expense, 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.

80. The plantation establishment expense, 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 plantation

establishment expense. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Prepayment provisions**

#### **Sections 82KZL to 82KZMF**

81. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

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

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

83. 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)).

84. 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.

85. 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.

86. 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.

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

88. 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**

89. 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).

90. 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.

91. 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.

92. 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.

93. Subsection 82KZMG(5) defines the 'establishment period' to commence at the time 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*

94. Under the Forestry Management Agreements, a Grower incurs a plantation establishment expense consisting of expenditure of \$11,522.50 for seasonally dependant agronomic activities’.

95. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2002 for 2002 Growers, or 30 June 2003 for 2003 Growers, for the expenditure incurred under the Forestry Management Agreements for ‘seasonally dependant agronomic activities’.

96. The Forestry Management Agreements also require that a Grower incur a management fee of \$165 per year during Years 2 to 15 for the performance of management services during the term of the Project. Under the Forestry Management Agreement a Grower incurs rent of \$495 to lease land during the term of the Project.

97. The management fees and rent incurred under the Forestry Management Agreements are not prepaid. These fees are charged for providing maintenance services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred.

98. 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.

99. 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*

100. Although not required under the Forestry Management Agreements, a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the ‘expenditure year’. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 99 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

101. 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.

102. However, as noted above, prepaid management fees and rent 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**

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

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

104. 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.

105. 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.

106. 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.

107. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

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- (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).

108. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one Timberlot in the Project is unlikely to have their activity 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 an earlier income year.

109. 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.

110. 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:

- because of its nature, it has not yet met 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.

111. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Timberlot in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the years ended 30 June 2012 and 30 June 2017 for 2002 Growers or 30 June 2013 and 30 June 2018 for 2003 Growers .

112. 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 2016 for 2002 Growers and 30 June 2017 for 2003 Growers. The taxation

profit that is projected for the income year ended 30 June 2012 for 2002 Growers, and 30 June 2013 for 2003 Growers 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.

113. 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 111), in the manner described in the Arrangement (see paragraphs 15 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.

114. 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**

115. 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**

116. 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).

117. Forestry Bond 2002 – Supplementary Prospectus 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 54 and 57 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.

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

## Examples

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

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

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