



PR 2002/82 - Income tax: Kiri Park Project No. 2 - Second Prospectus

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 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: Kiri Park Project No. 2

– Second 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

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 the product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of Use of this Product Ruling

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

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as 'Kiri Park Project No. 2', or just 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);
 - Sections 82KZME - 82KZMF (ITAA 1936);
 - Section 82KZMG (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation

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

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling 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.

9. Growers who elect to market their own produce are excluded from the class of persons to whom this Ruling applies (see paragraphs 38 and 51). Also, the class of persons will not include any Growers where a Conditional Allotment has been made under sub-clause 3.9 of the Constitution due to the approval process of an application subject to finance being incomplete by 30 June 2002 (see paragraph 49).

Qualifications

10. 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.

PR 2002/82

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Date of effect

12. 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).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Previous Rulings

15. This Ruling applies to the Project that was ruled upon in Product Ruling PR 2001/54. PR 2001/54 is now withdrawn on and from the date this Ruling is made. PR 2001/54 continues to apply to Growers who entered the Project during the period 20 February 2002 to the expiration of the first Prospectus on 9 May 2002. This Ruling

applies only to Growers taking up interests offered under the Second Prospectus.

Arrangement

16. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Original Application for Product Ruling dated 15 January 2001;
- The Kiri Park Project No. 2 Draft Prospectus, undated;
- Second Prospectus for the Kiri Park Project No. 2, dated 7 May 2002;
- Draft Constitution of the Kiri Park Project No. 2 dated 6 May 2002, received 27 May 2002;
- Draft Responsible Entity Services Agreement for the Kiri Park Project No. 2 between Environmental Forest Farms Management Ltd (the 'Manager') and Primary Securities Ltd (the 'Responsibility Entity'), undated;
- Draft Head Lease between Powton Land Holdings Ltd (the 'Lessor') and Environmental Forest Farms Management Ltd (the 'Lessee');
- Draft **Sub-Lease Agreement** for the Kiri Park Project No.2 between Environmental Forest Farms Management Ltd (the 'Sub-lessor'), Primary Securities Ltd (the 'Responsible Entity') and each Grower, received 7 May 2002;
- Draft **Management Agreement** for the Kiri Park Project No. 2 between each Grower and Environmental Forest Farms Management Ltd (the 'Manager'), Primary Securities Ltd (the 'Responsible Entity') and Primary Securities Ltd (the 'Bare Trustee'), received 22 May 2002;
- **Offer of Loan** between Powton Land Holdings Ltd (the "Lender") and the Grower, undated;
- **Finance Agreement** between EFF Ltd (the 'Lender') and the Borrower, received 28 May 2002;
- The Custodian Agreement dated 8 February 2000 between Primary Securities Ltd (the 'Responsible Entity') and the Custodian;

- Draft Compliance Plan for the Kiri Park Project No. 2, undated;
- Additional correspondence from the original application dated 30 March 2001, 8 April 2001, 12 April 2001 and 17 April 2001;
- Further correspondence dated 19 April 2002, 22 May 2002, 27 May 2002 and 28 May 2002.

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

17. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement to which this Ruling applies.

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

Overview

19. The salient features of the arrangement for the Kiri Park Project No. 2 – Second Prospectus are as follows:

Location	150 kms north of Perth in Western Australia, near Regans Ford in the Shire of Gingin
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Paulownia fortuneii</i> trees for the purpose of harvesting and selling timber
Number of hectares offered for cultivation	113
Size of each Woodlot	A minimum of 0.135 hectares
Number of trees per hectare	A maximum of 740 trees
Expected production	69.4 cubic metres of rough sawn timber per Woodlot
The term of the Project	Between 9 and 10 years
Initial cost	\$8,663.60 plus \$600 to acquire shares in the Lessor

Initial cost per hectare	\$64,175
Ongoing costs	Rent and Management fees Harvesting and marketing fees Optional insurance costs

20. The Project is a registered Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is Primary Securities Ltd. The Manager is Environmental Forest Farms Management Ltd ('EFFM'). The Project will be conducted on land known as 'Kiri Park' being:

- Lot M 1254 of diagram 5564 contained in Certificate of Title Volume 1807 Folio 985.

21. There is no minimum subscription for the Project. The Project commenced on the land described above under an earlier offer. The land for the Project is owned by Powton Land Holdings Ltd. Powton Land Holdings Ltd will lease the land to EFFM which in turn will sub-lease the Woodlot to the Grower to enable the Grower to carry on a long term commercial afforestation business.

22. The Land Owner is in the process of identifying further suitable land for Paulownia plantations. In the event of oversubscription, and subject to the approval of an Independent Forester, the Land Owner may secure additional land for the Project.

23. The Sub-Lease agreement provides for an area of land called a 'Woodlot' to be sub-let to the Grower for a term of approximately 9 years. Each Woodlot is 0.135 hectares in size and will be planted with at least 100 trees (740 per hectare) in the Spring of 2002. Approximately 113 hectares, representing 835 Woodlots, are available under the Second Prospectus offer. The Woodlots are separately identified in a plan of the Plantation.

24. Growers will also enter into a contract with the Manager for the management of their Woodlot. The Manager will be responsible for establishing and cultivating the trees and harvesting, processing and selling the timber. Tree thinning will occur from year 7. After 9 growing seasons the remaining trees will be harvested and processed to rough sawn timber lengths. Unless the Grower elects to take possession of their timber, the Manager will be responsible for arranging the marketing and sale of the timber.

25. Growers must also subscribe for shares in the land owning company, Powton Land Holdings Ltd. Applications must be made for a minimum of 6 shares at \$100 each. Growers may not hold more than 54% of the total shares on issue in Powton Land Holdings Ltd.

26. Upon Allotment, Growers appoint the Responsible Entity as their agent, enabling the Responsibility Entity to act on their behalf as required.

Constitution

27. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Primary Securities Ltd agrees to act as the Responsible Entity and to manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. The Responsible Entity will maintain a register of Growers.

28. Under the terms of the Constitution, all moneys received from applications will be paid to Primary Securities Ltd in its capacity as Bare Trustee, which shall deposit those moneys into a Trust Account. The Custodian will hold the funds as agent of the Responsible Entity under the Custodian Agreement. The Subscription Money from applications will be released to the Manager upon acceptance of an application, after which Woodlots are allocated. Applicants become Growers upon Allotment of their Woodlots and a Sub-Lease and Management Agreement will be executed on their behalf.

Compliance plan

29. As required by the Corporations Act a Compliance Plan has been prepared by Primary Securities Ltd. Its purpose is to establish a Compliance Committee to ensure the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in land

30. Growers participating in the arrangement will enter into a Sub-Lease agreement with Primary Securities Ltd and EFFM in its capacity as Sub-Lessor. Growers are granted an interest in land in the form of a sub-lease to use their Woodlots for the purpose of conducting their afforestation business until the final distribution of sale proceeds is made to the Grower or until the Project is terminated. Growers are specifically granted rights to harvest timber on their Woodlot for this purpose. The sub-lease is granted upon the terms and conditions outlined in the agreement.

31. Each Grower must pay rent to EFFM for each year of the Project in an amount specified in clause 4 of the Sub-Lease Agreement.

Management Agreement

32. Each Grower will enter into a Management Agreement with the Responsible Entity and EFFM in its capacity as Manager. The Management Agreement provides that each Grower appoints the Manager to perform services under the agreement. Clause 5 and Part 3 of the Schedule specify the services to be performed by the Manager. The Manager will supervise and manage all silvicultural activity on behalf of the Grower and must perform services including, but not limited to, the following:

- prepare and grade the Woodlots for the planting of the Trees (including the application of pesticides and fertilisers where necessary) within 12 months of the date of Allotment;
- select on behalf of the Grower, Trees which, to the best of its knowledge and belief, are high yielding *Paulownia fortuneii* Trees and to plant the Trees using generally accepted silvicultural methods within 12 months of the date of Allotment;
- plant out on the Plantation an average of no less than 100 Trees per Woodlot within 12 months of the date of Allotment;
- manage, maintain and cultivate the Woodlots, including growing, watering, weeding, pruning, selecting, procuring and applying appropriate fertilisers, nutrients, herbicides and doing all other things reasonably necessary for the purpose of maintaining and cultivating the Woodlots in accordance with good and proper silvicultural practices;
- keep each Woodlot free of competitive weeds, vermin, noxious animals and insects;
- replace any Trees that die during the 12 months following the date that planting of Trees on the Woodlots is first commenced, such that the Plantation has an average of no less than one hundred Trees per Woodlot growing at that time; and
- harvest, remove, mill, market and sell the Trees on behalf of the Grower (unless an election is made pursuant to clause 10 (see paragraph 38)).

Fees

33. Fees are payable under the Sub-Lease and the Management Agreement on a per Woodlot basis. The total of the fees payable on Application is \$8,663.60 represented as:

- Establishment Fee of \$7,205 payable to the Manager for the cost of trees and Woodlot preparation;
- Tree Planting Fee of \$495 payable to the Manager;
- Rent of \$113.30 payable to the Lessor for the First Year, being the period from the date of Allotment to 30 June 2003; and
- Management Fee of \$850.30 payable for the period from the date of Allotment to 30 June 2003.

34. Amounts payable in subsequent years are as follows:

- Management Fee of \$875.60 for managing and maintaining the Woodlot for the period 1 July 2003 to 30 June 2004 payable in advance on or before 1 June 2003;
- Management Fee of \$600.60 for the period 1 July 2004 to 30 June 2005 payable in advance on or before 1 June 2004;
- thereafter annual Management Fees will be set at the amount of the fee in the prior year indexed at the greater of 3% per annum or the annual rate of inflation and payable in advance on 1 June of each year;
- Rent is payable in respect of each financial year during the Term. The amount will be set at \$113.30 indexed at the greater of 3% per annum or the annual rate of inflation and payable in advance on 1 June of each year commencing on 1 June 2003.

35. The Manager is also entitled to the following amounts that will be deducted from the sales proceeds:

- an amount equal to 5.5% of the Net Proceeds of Sale for additional management and administration costs associated with harvesting and marketing (sub-clause 4.1(c) of the Management Agreement); and
- an Incentive Fee equal to 27.5% of the amount by which the Net Proceeds of Sale exceed the Net Harvest Return per Woodlot estimated in the Prospectus.

36. The Manager will maintain a public risk insurance policy in respect of the Plantation and such additional insurance, including fire insurance, as mutually agreed and paid for by the Grower (sub-clause 5(n) of the Management Agreement).

37. If, at any time during the term of the Management Agreement from 1 July 2003, the Manager calculates that the annual Management Fees, as stated in Part 2(b) of the Schedule, are insufficient to cover its costs and provide a commercial return to the Manager, it may obtain the approval of a Forestry Expert to increase those fees (sub-clauses 4.3 and 4.4 of the Management Agreement). Interest is payable on outstanding fees at the rate of 10% per annum (sub-clause 4.5).

Harvesting and Sale

38. The Grower is entitled to the Trees to be planted and the timber produced on their Woodlots. Growers may elect, by 30 June 2003, to sell their own timber produce by giving written notice to the Manager (sub-clause 10.1 of the Management Agreement). This Ruling does not apply to Growers who make such an election. The Manager will sell the timber harvested on behalf of the Growers who do not make such an election (defined for the purposes of this Ruling as 'Non-Electing Growers') for the highest price practicable (clause 9 of the Management Agreement).

39. The harvest will take place as and when deemed appropriate by the Manager in keeping with sound forestry practice but is expected to take place from year 7 to year 10. The timing of the harvest may be altered or deferred by the Manager notwithstanding that it may differ from any timing proposed in the Prospectus. The Manager will be responsible for arranging the marketing and sale of the timber produce.

40. The gross proceeds of the timber of Non-Electing Growers may be pooled and the Manager is appointed to sell the harvested timber. The Manager is to ensure that all sale proceeds will be paid in full to the Trust Account maintained by the Custodian for the Growers (clause 9 of the Management Agreement and clause 14.3 of the Compliance Plan). All Grower distributions are to be calculated by the Manager and are to be checked by a suitably qualified staff member of the Responsible Entity. Proceeds received are to be distributed in the following order of priority:

- to pay the Adjusted Prescribed Proportion of the costs of sales as advised by the Manager;
- to the Responsible Entity any outstanding Project Fees or other fee, costs, interest or taxes owing by the Grower to the Responsible Entity;

- to the Responsible Entity such amount as the Responsible Entity on the advice of the Manager reasonably estimates may be required within the following 12 months to pay for any estimated Project Fees which will become payable by the Grower;
- to pay the Manager any outstanding fees, costs or interest owing by the Grower to the Manager under the Management Agreement;
- to pay the Lessor any outstanding Rent or other fees, costs, interest, expenses or taxes owing by the Grower to the Lessor under the Sub-Lease; then
- to the Growers provided that if the aggregate sum to be distributed is less than \$1,000, then at the discretion of the Responsible Entity, distribution to Growers may be postponed. (clause 12 of the Constitution).

Finance

41. Growers can fund their investment in the Project themselves, borrow from Powton Land Holdings Ltd or EFF Ltd (lenders associated with the Responsible Entity or Manager) or borrow from an independent lender.

42. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers, for the purposes 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 Projects;
- 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;

- 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 Powton Land Holdings Ltd or EFF Ltd, are involved in the provision of finance for the Project.

43. Powton Land Holdings Ltd will offer Growers a loan to finance the Sub-Lease Fees and the Management Fees. The finance will be provided at a fixed interest rate of 11.5% for loans of up to \$5,000 per Woodlot and 12.0% for loans greater than \$5,000 per Woodlot. Interest is payable annually in advance.

44. The Principal Repayments are set out in Item 5 of the Loan Schedule. Under this item 100% repayment of the Principal outstanding on 1 June 2007 is payable no later than 29 June 2007. The loans are made on a full recourse basis, and Powton Land Holdings Ltd will pursue legal recovery action against defaulting borrowers to recover any loss suffered under the agreement.

45. EFF Ltd, the parent company of the Manager, will offer Growers finance to provide bridging or short term finance to finance the application moneys for the Woodlots. EFF Ltd will advance the sum set out in the Loan Agreement subject to the terms of the agreement. The type of finance will be elected by the Borrower under sub-clause 2.3 of the Loan Agreement.

46. Finance applications are subject to a Loan Application Fee of \$100 plus \$50 for each additional Woodlot. The Loan Application Fee is payable on application together with a deposit of \$1,400 for Woodlot fees and \$600 for the purchase of shares in Powton Land Holdings Ltd.

47. The Bridging Finance requires a deposit on application of \$2,100 per Woodlot plus a payment of \$7,263.60 per Woodlot within 30 days of signing the Agreement. The Bridging Finance is interest free.

48. The Short Term Finance requires a payment of \$2,100 per Woodlot (as described in paragraph 46 above) upon signing the Agreement, eleven monthly repayments of \$653.72 per Woodlot and a final repayment of \$653.71 per Woodlot. The effective annual interest rate is 8.0 %.

49. The Prospectus states that Applications subject to finance will not be accepted and Allotment will not occur until finance is approved and payment is received and cleared by the Custodian. Growers will be excluded from this Ruling where this process is not completed by 30 June 2002.

Ruling

Application of this Ruling

50. This Ruling applies only to Non-Electing Growers who are allotted Woodlots in the Project on or before 30 June 2002.

51. This Ruling does not apply to those Growers who make an election to market timber produced from their Woodlot(s) or are allotted Woodlots under sub-clause 3.9 of the Constitution.

52. 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.

The Simplified Tax System ('STS')

Division 328

53. For a Grower participating in this Project the recognition of income and the timing of tax deductions will depend upon whether, in an income year(s), the Grower is an 'STS taxpayer' or is not an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

54. 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.

Prepaid expenditure for Management Fees and Rent

Sections 82KZME and 82KZMF

55. The following expenditure incurred by a Grower who is accepted into this Project under the Second Prospectus, is subject to the prepayment rules in sections 82KZME and 82KZMF:

- annual Management Fees for the term of the Project; and

- annual Rent for the term of the Project.

56. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Other than expenditure deductible under section 82KZMG, where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii) of paragraph 64 below).

57. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

58. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 93 to 98.

Prepaid expenditure for 'seasonally dependent agronomic activities'

Section 82KZMG

59. Where certain advance expenditure, and the agreement under which that expenditure is incurred, meets the requirements of section 82KZMG, the formula in subsection 82KZMF(1) will not operate to determine the timing of the deduction allowable. The requirements of section 82KZMG are set out below in paragraphs 99 to 103.

60. Among other things, expenditure that complies with section 82KZMG must be for 'seasonally dependent agronomic activities' that are carried out by the Manager during the Project's 'establishment period'. The 'eligible service period' relating to this expenditure must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year.

61. Under the Management Agreement, for each Woodlot, a Grower incurs \$7,700 for 'seasonally dependent agronomic activities'. This expenditure is deductible in the income year that the Grower incurs this amount.

Tax outcomes for Growers who are not ‘STS taxpayers’

Assessable Income

Section 6-5

62. 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.

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

Deductions for Management fees, Rent and Interest

Section 8-1

64. A Grower who is not an ‘STS taxpayer’ may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Table on a per Woodlot basis:

Fee Type	ITAA 1997 Section	Year ended 30/06/2002	Year ended 30/06/2003	Year ended 30/06/2004
Establishment Fee	8-1	\$7,205 See Notes (i) & (ii) below		
Planting Fee	8-1	\$495 See Notes (i) & (ii) below		
Management Fees	8-1	Amount must be calculated – See Notes (i) and (iii) below	Amount must be calculated – See Notes (i) and (iii) below	Amount must be calculated – See Notes (i) and (iii) below
Rent	8-1	Amount must be calculated – See Notes (i) and (iii) below	Amount must be calculated – See Notes (i) and (iii) below	Amount must be calculated – See Notes (i) and (iii) below
Interest	8-1	As incurred – See Note (iv) below	As incurred – See Note (iv) below	As incurred – See Note (iv) below

Notes:

- (i) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 133.
- (ii) The Establishment Fee and Planting Fee are payable on application in respect of services to be provided within 12 months of the date of Allotment. The Establishment Fee and Planting Fee is expenditure for 'seasonally dependent agronomic activities' and is deductible in the year in which it is incurred (see paragraphs 99 to 103 in the Explanations).
- (iii) Where a Grower acquires one Woodlot in the Project and incurs the Management Fee and Rent as required by the Management Agreement and the Sub-Lease, those fees are deductible in the year incurred as 'excluded expenditure'. Excluded expenditure, being expenditure of less than \$1,000 is an exception to any prepayments rules that apply and is deductible in full in the year in which it is incurred. Where a Grower

acquires more than one Woodlot in the Project, then the amount and timing of the deduction allowable must be determined using the formula shown in paragraph 57 unless the expenditure is 'excluded expenditure'. See Examples 2 and 3 at paragraphs 134 and 135.

- (iv) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Powton Land Holdings Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with Powton Land Holdings Ltd or EFF Ltd should read carefully the discussion of the prepayment rules in paragraphs 91 to 98 below as those rules may be applicable if interest is prepaid.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

65. 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.

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

Deductions for Management fees, Rent and Interest

Section 8-1 and section 328-105

67. A Grower who is an 'STS taxpayer' may claim tax deductions for the revenue expenses in the following Tables on a per Woodlot basis. However, if for any reason, an amount shown in a Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer', such as under the finance arrangements offered by EFF Ltd, then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Application paid in full or financed by Powton Land Holdings Ltd

Fee Type	ITAA 1997 Section	Year ended 30/06/2002	Year ended 30/06/2003	Year ended 30/06/2004
Establishment Fee	8-1	\$7,205 See Notes (v) & (vi) below		
Planting Fee	8-1	\$495 See Notes (v) & (vi) below		
Management Fees	8-1	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below
Rent	8-1	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below
Interest	8-1	When paid – See Note (viii) below	When paid – See Note (viii) below	When paid – See Note (viii) below

EFF Ltd – Finance Offers

Fee Type	ITAA 1997 Section	Year ended 30/06/2002	Year ended 30/06/2003	Year ended 30/06/2004
Establishment Fee	8-1	Amount must be calculated – See Notes (v) & (vi) below		
Planting Fee	8-1	Amount must be calculated – See Notes (v) & (vi) below		
Management Fees	8-1	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below
Rent	8-1	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below	Amount must be calculated – See Notes (v) & (vii) below
Interest	8-1	When paid – See Note (viii) below	When paid – See Note (viii) below	When paid – See Note (viii) below

Notes:

- (v) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits):
Division 27. See Example 1 at paragraph 133.
- (vi) The Establishment Fee and Planting Fee are payable on application in respect of services to be provided within 12 months of the date of Allotment. The Establishment Fee and Planting Fee is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the year in which it is paid (see paragraphs 99 to 103 in the Explanations).
- (vii) Where a Grower acquires one Woodlot in the Project and incurs the Management Fee and Rent as required

by the Management Agreement and the Sub-Lease, those fees are deductible in the year incurred as 'excluded expenditure'. Excluded expenditure, being expenditure of less than \$1,000 is an exception to any prepayments rules that apply and is deductible in full in the year in which it is incurred. Where a Grower acquires more than one Woodlot in the Project, then the amount and timing of the deduction allowable must be determined using the formula shown in paragraph 57 unless the expenditure is 'excluded expenditure'. See Examples 2 and 3 at paragraphs 134 and 135.

- (viii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Powton Land Holdings Ltd or EFF Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with Powton Land Holdings Ltd or EFF Ltd should read carefully the discussion of the prepayment rules in paragraphs 91 to 98 below as those rules may be applicable if interest is prepaid.

Tax outcomes that apply to all Growers

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

Section 35-55 - Commissioner's discretion

68. For a Non-Electing Grower who is an individual and who enters the Project during the year ended 30 June 2002, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2008 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

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

- the 'exception' in subsection 35-10(4) applies; or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- 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)).

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

71. 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

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

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

Explanations

Is the Grower carrying on a business?

73. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in Kiri Park Project No. 2 must amount to the carrying on of a business of primary production.

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

75. For schemes such as that of Kiri Park Project No. 2, 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* (1984) 16 ATR 55; 84 ATC 4929.

76. 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 licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

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

78. Under the Sub-Lease each individual Grower will have rights over a specific and identifiable area of at least 0.135 hectares of land. The agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Sub-Lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Agreement allows the Manager to come onto to the land to carry out its obligations.

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

80. The Manager is also engaged to harvest and sell, on behalf of the Grower, the timber grown on the Grower's leased area.

81. 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.

82. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based

on reasonable projections, a Grower in the Project will derive assessable income from the sale of timber that will return a before-tax profit, i.e. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

84. The 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).

85. The Grower's degree of control over the 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 leased area and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

86. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the Kiri Park Project No. 2 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

87. 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.

88. 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 Rent and Management fees***Section 8-1***

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

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

90. The management fees and sub-lease fees associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fees appear to be reasonable. There is no capital component of the Establishment Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayments provisions***Sections 82KZL to 82KZMG***

91. 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.

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

Sections 82KZME and 82KZMF

93. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see paragraph 97 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)).

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

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

95. 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 Powton Land Holdings Ltd or EFF 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.

96. 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.

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

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

98. 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

99. 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).

100. 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.

101. 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:
 - (a) there must be more than one participant in the agreement in the same capacity as the taxpayer who incurs the expenditure; or
 - (b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

102. 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.

103. 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

Establishment Fee and Planting Fee

104. Under the Management Agreement, a Grower incurs an Establishment Fee and a Planting Fee. These fees consist of expenditure for ‘seasonally dependent agronomic activities’. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the expenditure is incurred

under the Management Agreement for ‘seasonally dependent agronomic activities.

105. A Grower entering the Project under the Second Prospectus who is an ‘STS taxpayer’ can, therefore, claim an immediate deduction for the Establishment Fee and the Planting Fee in the income year in which the fees are paid. A Grower who is not an ‘STS taxpayer’ can claim an immediate deduction for the Establishment Fee and the Planting Fee in the income year in which the fee is incurred.

Management Fees and Rent

106. The Management Agreement also requires that a Grower incurs Management Fees for each year of the Project, commencing in Year 1 with an amount of \$850.30 for the performance of maintenance services during the term of the Project. Under the Sub-Lease a Grower incurs Rent of \$113.30 per annum (indexed) to lease land during the term of the Project.

107. This expenditure meets the requirements of subsections 82KZME(1) and (2) and is incurred under an ‘agreement’ as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

108. The prepaid Management Fee for Years 1 to 8 and the prepaid Rent, being amounts of less than \$1,000 in each expenditure year, constitute ‘excluded expenditure’ as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) ‘excluded expenditure’ is specifically excluded from the operation of section 82KZMF. 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.

109. However, where a Grower acquires more than the minimum allocation of one Woodlot in the Project and the quantum of the prepaid Management Fee and/or the prepaid Rent is \$1,000 or more, the deduction allowable for those amounts will instead be subject to apportionment according to the formula in subsection 82KZMF(1).

Interest deductibility

Section 8-1

(i) Growers who use Powton Land Holdings Ltd as the finance provider

110. Some Growers may finance their participation in the Project through a loan facility with Powton Land Holdings Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of sub-lease and management fees.

111. The interest incurred for the year ended 30 June 2002 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.

112. As with the management fees and the sub-lease fees, in the absence of any application of the prepayment provisions (see paragraphs 91 to 98), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

114. 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 Powton Land Holdings Ltd as the finance provider

115. 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 Powton Land Holdings 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.

116. 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 91 to 98).

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

117. 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.

118. 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.

119. 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.

120. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

121. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);

- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

122. 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 in the Project of one interest during the year ended 30 June 2002 is unlikely to have their activity pass one of the tests until the year ended 30 June 2011. 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.

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

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

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

125. Information provided with this Product Ruling indicates that a Non-Electing Grower who acquires the minimum allocation 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 each of the income years ended 30 June 2009 to 30 June 2012.

126. 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 until the year ended 30 June 2008.

127. 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 68) in the manner described in the Arrangement (see paragraphs 19 to 49). 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 10) the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

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

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

Section 82KL

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

Part IVA – general tax avoidance provisions

130. 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).

131. The Kiri Park Project No. 2 will be a 'scheme' commencing with the issue of the Prospectus. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 64 and 67 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

132. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the

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

Examples

Example 1 - Entitlement to GST input tax credits

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

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

*Taxable supply

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

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

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

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

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

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

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

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

Example 2 – prepaid expenditure and the apportionment of fees

134. Ray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and, thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Ray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Ray that the minimum subscription has been reached and the Project will go ahead. Ray's agreements are duly executed and management services start to be provided on that date.

Ray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Ray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000 and represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Ray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Ray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Ray in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Ray's total tax deduction for management fees in 2002).

Ray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

135. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3,600 \times \frac{365}{365}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Detailed contents list

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Commissioner of Taxation

5 June 2002

<i>Previous draft:</i>	<i>Legislative references:</i>
Not previously issued in draft form	- ITAA 1936 82KL
	- ITAA 1936 82KZL
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZL(1)
IT 360; TR 92/1; TR 92/20;	- ITAA 1936 82KZME
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- advance deductions and expenses for certain forestry expenditure	- ITAA 1936 82KZMF
- carrying on a business	- ITAA 1936 82KZMF(1)
- commencement of business	- ITAA 1936 82KZMG
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