PR 2002/85 - Income tax: Queensland Paulownia Forests Project No 6

Product Ruling
Income tax: Queensland Paulownia Forests Project No 6

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

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Queensland Paulownia Forests Project No 6, 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 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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

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

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling these persons are referred to as 'Growers'. The class of persons to whom this Ruling applies does not include Growers who elect to collect the timber attributable to their Woodlots themselves (see paragraphs 24 and 35).

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

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission

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Date of effect

11. This Ruling applies prospectively from 12 June 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 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 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

14. This Ruling replaces Product Ruling PR 2001/176, which is withdrawn on and from the date this Ruling is made. Product Ruling PR 2001/176 will continue to apply to investors who entered into the Project on or before 31 May 2002.

Arrangement

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

- Application for a Product Ruling from Queensland Paulownia Forests Ltd (QPFL) dated 7 June 2001 in respect of Queensland Paulownia Forests Project No 6;
- Prospectus issued by QPFL and dated 1 November 2001;
- Draft Supplementary Prospectus of 11 December 2001;
- Constitution of QPFL Project No. 6 dated 1 October 2001, ('the Constitution');
- Supplemental Constitution of 26 October 2001;
- Draft Second Supplemental Constitution of 11 December 2001;
- Compliance Plan for the Queensland Paulownia Forests Project No. 6 ('the Compliance Plan');
- Discussions between the Australian Taxation Office and the Applicant dated 14 August 2001, 24 September 2001, 9 November 2001, 30 November 2001 and 11 December 2001 and the Applicant's e-mail of 6 December 2001;
- Additional written correspondence dated 6 December 2001;
- Application for a Variation Product Ruling from Queensland Paulownia Forests Ltd (QPFL) dated 11 April 2002 in respect of Queensland Paulownia Forests Ltd Project No 6;
- **Draft Second Plantation and Maintenance Agreement between QPFL and the Grower;**
- **Draft Second Farming Agreement between QPFL and the Grower**;
- **Finance Agreement between QPFL and the Grower;**
- Draft Third Supplemental Constitution dated 11 April 2002;
- Draft Second Supplementary Prospectus dated 11 April 2002; and
- Discussions between the Australian Taxation Office and the Applicant dated 22 April 2002 and e-mails from the Applicant dated 23 April 2002, 29 April 2002,

3 May 2002, 23 May 2002, 27 May 2002, 30 May 2002, 3 June 2002, 4 June 2002 and 5 June 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. The effect of the agreements may be summarised as follows.

Overview

18. This arrangement is called the Queensland Paulownia Forests Project No 6.

Location	'Austin Downs' Surat
Type of business each participant is carrying on	Commercial growing and cultivation of Paulownia trees for the purpose of harvesting and selling timber.
Number of Woodlots on offer	2,000
Minimum number of Woodlots per application	2
Number of hectares available	428 hectares
Size of each Woodlot	0.2 hectares
Number of trees per Woodlot	52
Incentive fee	Responsible Entity will be entitled to 1/3 of the Gross Sale proceeds of the timber over and above the financial forecasts in the Prospectus.
The term of the investment	Until 30 June 2013 unless the trees are harvested and milled earlier.
Initial cost	$5,494 per Woodlot
Initial cost per hectare	$27,470
Ongoing costs	Maintenance fees, licence fees, harvesting and milling, marketing and

	selling fees and insurance (where applicable)

19. Under the Prospectus, applicants are invited to participate in the Queensland Paulownia Forests Project No 6. Growers entering into the Project will enter into the Second Farming Agreement that gives them a licence over an area of land called a 'Woodlot'. The Land Owner (Queensland Forestry Holdings Pty Ltd) leases the land, at 'Austin Downs', Surat, to QPFL who grants a licence to the Growers. The Growers will also enter into the Second Plantation and Maintenance Agreement with QPFL to have certain paulownia trees (*paulownia fortunei*) planted on the Woodlot for the purpose of eventual felling and sale in approximately eight years.

20. There are 2,000 Woodlots on offer of 0.2 hectares each at a cost of $5,494 per Woodlot. A Grower must apply for a minimum of 2 Woodlots. The total land area for the Project will be 428 hectares. A minimum of 52 trees per Woodlot (260 per hectare) will be planted within the 1st 12 months following execution of the Plantation and Maintenance Agreement. Growers execute a Power of Attorney enabling QPFL to act on their behalf as required when they make an application for Woodlots.

21. For applicants who are accepted into the Project and whose Agreements are executed up to, and including the 30 June 2002, QPFL will provide all services relating to the Year 1 planting and maintenance fee within the first twelve months of the Agreements. Similarly, for applicants who are accepted into the Project on or after 1 July 2002, the services relating to the Year 1 planting and maintenance fee will be supplied within the first twelve months of the Agreements.

Second Farming Agreement

22. The Second Farming Agreement is entered into between QPFL and the Grower for each Woodlot by the Grower signing the Application and Limited Power of Attorney Form in the Prospectus. Growers are granted a licence to use their Woodlot for the purpose of conducting their afforestation business (cl 2.1). The Growers must pay QPFL a licence fee of $165 per Woodlot per annum (cl 6). This fee is indexed annually. The Manager must apply the licence fee to payment of rent under the lease. The term of the Agreement is either until 30 June 2013 or until harvesting and milling of all trees has been completed, whichever is the earlier (cl 3.1). The Agreement is subject to the terms of the Constitution.

Second Plantation and Maintenance Agreement

23. The Second Plantation and Maintenance Agreement for each Woodlot is entered into by the Grower signing the Application and Limited Power of Attorney Form in the Prospectus. The term of the Agreement is either until 30 June 2013 or until harvesting and milling of all trees has been completed, whichever is the earlier (cl 3(a)).

24. The services to be provided by QPFL for an annual fee over the term of the Project are outlined in clause 4 of the Second Plantation and Maintenance Agreement. QPFL will be responsible for planting *paulownia fortunei* on the Woodlot and will then maintain the trees in accordance with good silvicultural practice until maturity. Sufficient water is available for this Project from the property's 800 megalitre capacity dam and the creek running through the property. Prior to 30 June 2009, Growers may elect to collect the timber attributable to their Woodlots (Electing Growers) (cl 9.1) instead of having it milled and marketed on their behalf by QPFL. This Ruling will not apply to Electing Growers. If no such election is made, QPFL will sell the timber attributable to the Woodlots on the (Non- Electing) Grower's behalf, for the best possible commercial price (cl 6.2). QPFL will then be entitled to a marketing fee of 5.5% of the proceeds from the sale of the timber. Harvesting and milling of trees will take place between 30 June 2010 and 31 December 2010 or at another time as determined by QPFL (cl 5).

25. Growers who do not elect to collect their own timber will have the gross proceeds of sale of the timber attributable to their Woodlots paid to the Responsible Entity in its capacity as Custodian of the Project. The Responsible Entity will retain from the payment the Grower's proportional interest of the harvesting and milling costs, other costs of sale, any outstanding fees owing by the Grower and the Marketing and Incentive fee. After payment of these expenses, the Responsible Entity will account to the Grower and pay the Grower his/her share of the gross proceeds of sale.

Constitution

26. The Constitution is between QPFL (in its capacity as the Responsible Entity) and Growers. The Constitution sets out the terms and conditions under which QPFL agrees to act for the Growers and under which QPFL agrees to manage the Project. QPFL keeps a register of Growers. Growers are only entitled to assign the Grower's Interest in certain circumstances (cl 18). Growers are bound by the Constitution by virtue of their participation in the Project.

Fees

27. The fees payable under clause 10 of the Second Plantation and Maintenance Agreement are:

(i) **$**5,329 per Woodlot for the services provided within the next twelve months from the acceptance of the Application for a Woodlot made under the Prospectus. Of this figure, $5,038 is for 'seasonally dependent agronomic activities', which leaves a balance of $291 per Woodlot that is for non 'seasonally dependent agronomic activities';

(ii) $231 per Woodlot per annum commencing on the start of the 13th month following the execution of the Second Plantation and Maintenance Agreement and indexed thereafter;

(iii) an incentive fee calculated to be 1/3 of the gross sale proceeds of the Grower's timber over and above the financial forecasts in the Prospectus for the Project;

(iv) a marketing fee of not more than 5.5% of the gross proceeds generated from the sale of timber attributable to the Grower's Woodlot where QPFL sells on the Growers behalf.

28. The fee payable under clause 6 of the Second Farming Agreement is a licence fee of $165 per Woodlot per annum (indexed) initially paid on application under the Prospectus and then on the start of the 13th month following execution of the Second Farming Agreement.

29. The Responsible Entity will hold the application moneys in an application account to be released when certain specified criteria in the Constitution have been met (cl 15).

Finance

30. Growers can fund their investment in the Project themselves, borrow from QPFL or borrow from an independent lender.

31. Where a Grower borrows from QPFL, the company will have full recourse to the Borrower's assets should the Borrower (Grower) default, and it will pursue appropriate legal action against defaulting Growers. Funds borrowed from QPFL, or received directly from Growers, are paid direct to the Application Account prior to a Grower being accepted into the Project. No round robin arrangements are involved and QPFL will use these funds after the Grower is accepted into the Project, subject to authorisation by the Custodial Committee, in carrying out its obligations under the Constitution.

32. Where a Grower borrows from QPFL, two finance options are offered:

(a)

(i) At least the first month's payment is required in advance;

(ii) Straight principal and interest payments over a 1 to 5 year term;

(iii) The Grower may pay out the loan at any time during the term; and

(iv) The interest rate will be not greater than 7% over the average 1 to 5 year SWAP rate for the month end preceding the signing of the Finance Agreement as posted in the Financial Review, but in any event not less than 4% above the SWAP rate;

(b)

(i) At least 20% deposit required;

(ii) Repayments over a 1 to 5 year term;

(iii) No repayments until the next 1 July after the date of allocation of the Woodlots;

(iv) Interest charged from drawdown of loan;

(v) The Grower may pay out the loan at any time during the term; and

(vi) The interest rate will be not greater than 8% over the average 1 to 5 year SWAP rate for the month end preceding the signing of the Finance Agreement as posted in the Financial Review, but in any event not less than 4% above the SWAP rate.

33. Clause 9 of the Finance Agreement sets out the Lender's rights on default.

34. 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 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; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project, other than QPFL, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

35. This Ruling applies only to Non-Electing Growers who are accepted to participate in the Project either on or before 30 June 2002, or, between 1 July 2002 and 1 December 2002 and who have executed the Second Plantation and Maintenance Agreement and the Second Farming Agreement on or before the 30 June 2002 in the first instance and 1 December 2002 in the second. The Grower's participation in the Project must constitute the carrying on of a business of primary production. This Ruling will not apply to Growers who elect to collect the timber attributable to their own Woodlot.

36. 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

37. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

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

Qualification

38. 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 planting and maintenance services

Sections 82KZME and 82KZMF

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

- $291 for that part of the Year 1 planting and maintenance fee that is not expenditure that is deductible under section 82KZMG (see below).

40. 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'. For a Grower who acquires the minimum allotment of two Woodlots in this Project, that part of the expenditure for the Year 1 plantation and maintenance fee that is not deductible under section 82KZMG will be 'excluded expenditure'. (See Note (iii) below.)

41. Where expenditure for the Year 1 planting and maintenance fee is not deductible under section 82KZMG and is NOT 'excluded expenditure, 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.

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

42. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 77 to 84.

Prepaid expenditure for 'seasonally dependent agronomic activities'

Section 82KZMG

43. 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 85 to 89.

44. 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.

45. Under the Second Plantation and Maintenance Agreement, for each Woodlot, a Grower incurs $5,038 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

46. 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.

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

Deductions for planting and maintenance fees, licence fees and interest

Section 8-1

48. A Grower who is not an 'STS taxpayer' and who is accepted into the Project on or before 30 June 2002 may claim, on a per Woodlot basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Year 1 Planting & Maintenance Fee - for 'seasonally dependent agronomic activities'	8-1	$5,038 See Notes (i) & (ii) (below)		
Balance of Year 1 Plantation and Maintenance Fees	8-1	$291 See Notes (i) & (iii) below		
Maintenance fees (Year 2 onwards)	8-1		$231 (Indexed) – See Notes (i) & (iv) (below)	$231 (Indexed) – See Notes (i) & (iv) (below)
Licence Fee	8-1	$165– See Notes (i) & (iv) (below)	$165 (indexed)– See Notes (i) & (iv) (below)	$Previous year's fee (indexed)– See Notes (i) & (iv) (below)
Interest on loan with QPFL	8-1	As incurred See Note (v) (below)	As incurred See Note (v) (below)	As incurred See Note (v) (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 124.

(ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.

(iii) Although the Second Plantation and Maintenance Agreement requires the Year 1 plantation and maintenance fee to be prepaid, for a Grower who acquires the minimum allocation of two Woodlots, the amount of the prepaid plantation and maintenance fee not deductible under section 82KZMG is less than $1,000. For the purposes of this Project, an amount of less than $1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 126). However, where a Grower acquires more than the minimum allocation in the Project, the amount of these prepaid fees may be $1,000 or more. Where this occurs, such Growers MUST determine the relevant deduction for the prepaid planting and maintenance fee, using the formula shown above in paragraph 41. These Growers should carefully read the Explanations relating to the prepayment rules to correctly determine their deductions (see paragraphs 77 to 98 below).

(iv) Where a Grower who is not an 'STS taxpayer', pays the maintenance fee and the licence fee in the relevant income years shown, respectively, in the Second Plantation and Maintenance Agreement and the Second Farming Agreement, those fees are deductible in full in the year that they are incurred. However, if a Grower chooses to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 77 to 98 below). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 41 unless the expenditure is 'excluded expenditure'.

(v) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than QPFL, is outside the scope of this Ruling. However all Growers, including those who finance their

participation in the Project other than with QPFL, should read the discussion of the prepayment rules in paragraphs 77 to 98 (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.

49. A Grower who is not an 'STS taxpayer' and who is accepted into the Project between 1 July 2002 and 1 December 2002 may claim on a per Woodlot basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	**ITAA 1997 Section**	**Year ended 30 June 2003**	**Year ended 30 June 2004**	**Year ended 30 June 2005**
Year 1 Planting and Maintenance Fees for 'seasonally dependent agronomic activities'	8-1	$5,038 See Notes (i) & (ii) (above)		
Balance of Year 1 Planting and Maintenance Fees	8-1	$291 See Notes (i) & (iii) (above)		
Maintenance fees (Year 2 onwards)	8-1		$231 (indexed) – See Notes (i) & (iv) (above)	$231 (indexed) – See Notes (i) & (iv) (above)
Licence Fee	8-1	$165– See Notes (i) & (iv) (above)	$165 (indexed)– See Notes (i) & (iv) (above)	$Previous year's fee (indexed)– See Notes (i) & (iv) (above)
Interest on loan with QPFL	8-1	As incurred See Note (v) (above)	As incurred See Note (v) (above)	As incurred See Note (v) (above)

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

50. 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.

51. 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 planting and maintenance fees, licence fees and interest

Section 8-1 and section 328-105

52. A Grower who is an 'STS taxpayer' and who is accepted into the Project on or before 30 June 2002 may claim, on a per Woodlot basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Year 1 Planting & Maintenance Fees for 'seasonally dependent agronomic activities'	8-1	$5,038 See Notes (vi) & (vii) (below)		
Balance of Year 1 Planting & Maintenance Fees	8-1	$291 See Notes (vi) & (viii) (below)		
Maintenance Fees (Year 2 onwards)	8-1		$231 (indexed) – See Notes (vi) & (ix) (below)	$231 (indexed) – See Notes (vi) & (ix) (below)
Licence Fee	8-1	$165 – See Notes (vi) & (ix) (below)	$165 (indexed) – See Notes (vi) & (ix) (below)	$Previous year's fee (indexed) – See Notes (vi) & (ix)

				(below)
Interest on loan with QPFL	8-1	As incurred See Note (x) (below)	As incurred See Note (x) (below)	As incurred See Note (x) (below)

Notes:

(vi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits). See Example 1 at paragraph 124.

(vii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred and paid.

(viii) Although the Second Plantation and Maintenance Agreement requires the Year 1 plantation and maintenance fee to be prepaid, for a Grower who acquires the minimum allocation of two Woodlots, the amount of the prepaid plantation and maintenance fee not deductible under section 82KZMG, is less than $1,000. For the purposes of this Project, an amount of less than $1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is an 'STS taxpayer', is deductible in full in the year in which it is incurred and paid (see Example 3 at 126). However, where a Grower acquires more than the minimum allocation in the Project, the amount of these prepaid fees may be $1,000 or more. Where this occurs, such Growers MUST determine the relevant deduction for the prepaid planting and maintenance fee, using the formula shown above in paragraph 41. These Growers should carefully read the Explanations relating to the prepayment rules to correctly determine their deductions (see paragraphs 77 to 98 below).

(ix) Where a Grower who is an 'STS taxpayer', pays the maintenance fees and the licence fee in the relevant income years shown, respectively, in the Second Plantation and Maintenance Agreement and the Second Farming Agreement, those fees are not prepayments and 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 may apply

to apportion those fees (see paragraphs 77 to 98 below). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 41, unless the expenditure is 'excluded expenditure'.

(x) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than QPFL, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with QPFL, should read the discussion of the prepayment rules in paragraphs 77 to 98 (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.

53. A Grower who is an 'STS taxpayer' and who is accepted into the Project between 1 July 2002 and 1 December 2002 may claim on a per Woodlot basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Year 1 Planting and Maintenance Fees for 'seasonally dependent agronomic activities'	8-1	$5,038 See Notes (vi) & (vii) (above)		
Balance of Year 1 Planting & Maintenance	8-1	$291 See Notes (vi) & (viii) (above)		
Maintenance Fees (Year 2 onwards)	8-1		$231 – See Notes (vi) & (ix) (above)	$231 – See Notes (vi) & (ix) (above)
Licence Fee	8-1	$165 – See Notes (vi) & (ix) (above)	$165 (indexed) – See Notes (vi) & (ix) (above)	$Previous year's fee (indexed) – See Notes (vi) & (ix) (above)
Interest on loan with	8-1	As incurred See Note (x)	As incurred See Note (x)	As incurred See Note (x)

QPFL		(above)	(above)	(above)

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner's discretion

54. 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 2010 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. Similarly, for a Non-Electing Grower who enters the Project during the year ended 30 June 2003, the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2011 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.

55. 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 112 in the Explanations part of this ruling, below); or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

56. 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.

57. 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

58. For a Grower who participates in the Project and incurs expenditure as required by the Second Plantation and Maintenance Agreement and the Second Farming 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?

59. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Queensland Paulownia Forests Project No 6 must amount to the carrying on of a business of primary production.

60. 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.

61. For schemes such as that of the Queensland Paulownia Forests Project No 6, 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) 16 ATR 55.

62. 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 wood produce from those trees;

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

63. In this Project, each Grower enters into the Second Plantation and Maintenance Agreement and the Second Farming Agreement.

64. Under the Second Farming Agreement each individual Grower will have rights over a specific and identifiable area of 0.2 hectares of land. The Second Farming Agreement provides the Grower with an ongoing interest in the specific trees on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The licence allows the Project Manager to come onto the land to carry out its obligations under the Second Plantation and Maintenance Agreement.

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

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

67. 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.

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

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

70. The Project Manager's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

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

71. The Grower's degree of control over the Project Manager as evidenced by the Second Plantation and Maintenance Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Woodlot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

72. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the Queensland Paulownia Forests Project No 6 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

73. 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.

74. 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 planting and maintenance fees and licence fees

Section 8-1

75. Consideration of whether the initial planting and maintenance fees and licence fees 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.

76. The planting and maintenance fees and licence 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 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 Planting and maintenance fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMG

77. 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.

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

Sections 82KZME and 82KZMF

79. 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)).

80. 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.

81. 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 QPFL. 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.

82. 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.

83. 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.

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

84. 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

85. 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).

86. 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.

87. 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.

88. 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.

89. 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

90. Under the Second Plantation and Maintenance Agreement, a Grower incurs a Year 1 planting and maintenance fee of $5,329 consisting of expenditure of $5,038 for 'seasonally dependent agronomic activities' and expenditure of $291 for other maintenance activities.

91. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2002 for Growers entering the Project by 30 June 2002, or in the year ended 30 June 2003 for Growers entering the Project between 1 July 2002 and 30 June 2003 for the expenditure incurred under the Second Plantation and Maintenance Agreement for 'seasonally dependent agronomic activities'.

92. The balance of the expenditure incurred under the Second Plantation and Maintenance Agreement in Year 1 ($291 per Woodlot) does not meet the requirements of section 82KZMG. Therefore, unless one of the exceptions to section 82KZME applies the amount and timing of tax deductions for this fee is determined under section 82KZMF.

93. For a Grower that acquires the minimum allocation of two Woodlots, the balance of the prepaid planting and maintenance fee, being an amount of less than $1,000, constitutes '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 the planting and maintenance fee in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the planting and maintenance fee in the income year in which the fee is incurred.

94. However, where a Grower acquires more than the minimum investment of two interests in the Project and the quantum of the prepaid planting services fee 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). Section 82KZMF will apportion the deduction for this part of the prepaid Year 1 planting and maintenance fee over the period that the services, for which the prepayment is made, are provided.

95. The Second Plantation and Maintenance Agreement also requires that a Grower incurs a maintenance fee of $231 (indexed from Year 2) per year from Years 2 onward for the performance of maintenance services during the term of the Project. Under the Second Farming Agreement a Grower incurs licence fees of $165 (indexed) to acquire rights over the land during the term of the Project.

96. The maintenance fee incurred under the Second Plantation and Maintenance Agreement in Years 2 onward and the licence fees incurred under the Second Farming Agreement are not prepaid. These fees are charged for providing services and for the licence of the land to a Grower until 30 June of the year in which the fees are incurred.

97. 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 maintenance fees in Years 2 onward and the licence fees.

98. 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*

99. Although not required under either the Second Plantation and Maintenance Agreement, the Second Farming Agreement, or the Loan Agreement with QPFL (see below), a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the

'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 97 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

101. However, as noted above, prepaid fees of less than $1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Interest deductibility

Section 8-1

(i) Growers who use QPFL as the finance provider

102. Some Growers may finance their participation in the Project through a loan facility with QPFL. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of licence and management fees.

103. For a Grower who is accepted into the Project by 30 June 2002, 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 licence 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. Similarly for a Grower who is accepted into the Project between 1 July 2002 and 30 June 2003, 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 licence 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.

104. As with the management fees and the licence fees, in the absence of any application of the prepayment provisions (see paragraphs 77 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'.

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

106. 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 QPFL as the finance provider

107. 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 QPFL 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.

108. 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 77 to 98).

Deferral of losses from non-commercial business activities

Division 35

109. 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.

110. 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.

111. 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.

112. 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.

113. In broad terms, the tests require:

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

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);

(c) at least $500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

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

114. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Non - Electing Grower who acquires the minimum allocation of 2 Woodlots in the Project in the year ended 30 June 2002 is unlikely to have their activity pass one of the tests until the income year ended 30 June 2011. Similarly a Non–Electing Grower who acquires the minimum allocation of 2 Woodlots in the Project in the year ended 30 June 2003 is unlikely to have their activity pass one of the tests until the income year ended 30 June 2012. 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.

115. 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.

116. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be

exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years;

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

117. Information provided with this Product Ruling indicates that a Non – Electing Grower who acquires the minimum investment of 2 Woodlots in the Project in the year ended 30 June 2002 is expected to be carrying on a business activity that will either pass one of the tests or produce a taxation profit, for the income year ended 30 June 2011. 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 2010. Similarly, a Non–Electing Grower who acquires the minimum investment of 2 Woodlots in the Project in the year ended 30 June 2003 is expected to be carrying on a business activity that will either pass one of the tests or produce a taxation profit, for the income year ended 30 June 2012. 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 2011.

118. 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 53) in the manner described in the Arrangement (see paragraphs 15 to 34). 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.

119. 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, the independent marketing consultant and additional expert evidence provided with the application by QPFL;
- 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 QPFL.

Section 82KL - recouped expenditure

120. 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

121. 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).

122. The Queensland Paulownia Forests Project No6 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 48 – 49, and 52 - 53 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.

123. 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

124. 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	$2 200*
Total due and payable by 1 January 2002 (includes GST of $600)	$6 600

*Taxable supply

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

1/11 x $4400 = $400.

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

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

1/11 x $2200 = $200.

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

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

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

Example 2 – Apportionment of Fees

125. Murray 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 for each Woodlot are $5,000 in Year 1, consisting of $4,500 for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' and $500 for other management activities. The management fee for Year 2 and 3 is $400. 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. Murray makes an application for 3 Woodlots in the project and 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 2002 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows.

First, that part of the Year 1 management fees that is for 'seasonally dependent agronomic activities', is deductible in full in the income year ended 30 June 2002. As Murray has 3 interests in the project this amount is ($4,500 x 3) $13,500.

Murray is also entitled to part of the deduction for the management fees related to other management activities (i.e., those management activities that are not 'seasonally dependent agronomic activities'). This amount is determined using the following formula.

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

$$\$1{,}500 \times \frac{26}{365}$$

= **$107** (therefore Murray's total tax deduction in 2002 for 3 Woodlots for the Year 1 prepaid management fees of $15,000 is $13,607. It represents the sum of the amount paid for 'seasonally dependent agronomic activities' plus an amount for the 26 days for which the other management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$1{,}500 \times \frac{339}{365}$$

= **$1,393** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

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

= **$85** (this represents the portion of the Year 2 prepaid management fees for 3 Woodlots for the 26 days during which services were provided to Murray in the 2003 income year).

$1,393 + $85 = $1,478 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

For the term of the project, Murray continues to use this method to calculate his tax deduction for the prepaid management fees for his 3 Woodlots.

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

126. On 1 June 2002 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 1 hectare Woodlot and the provision of management services between the 1 July and 30 June in the following income year. On 15 June 2002 Kevin pays the Year 1 lease fee of $400 and the Year 1 management fee of $8,600. The Year 1 management fee is made up of $7,500 for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' and $1,100 for other management services.

Kevin, who is not an 'STS taxpayer' is not registered, nor required to be registered for GST.

He calculates his tax deduction for management fees and the lease fee for the **2002 income year** as follows:

Management fee

Even though he paid the $8,600 in the 2002 income year, Kevin is only able to claim a deduction of $7,500 for the 'seasonally dependent agronomic expenditure' in that income year. Because there are no 'days of eligible service period' in the 2002 income year, Kevin is unable to claim any part of the management fees paid to the manager for other management services, as a tax deduction in his tax return for the year ended 30 June 2002.

Lease fee

Because the $400 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 2002.

In the **2003 income year** Kevin can claim a tax deduction for that part of his first year's management fees that was not deductible in the 2002 income year. The tax deduction is calculated as follows:

$$\$1{,}100 \times \frac{365}{365}$$

= **$1,100** (this represents the whole of that part of the first year's management fee prepaid in the 2002 income year for management services that are not 'seasonally dependent agronomic activities' undertaken by the manager in the 'establishment period'. Although this amount was incurred in the 2002 income year it is not deductible until the 2003 income year).

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

Detailed contents list

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

Commissioner of Taxation
12 June 2002

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
TR 92/1; TR 92/20; TD 93/34; TR 97/11; TR 97/16; TR 98/22; TR 2000/8; PR 1999/95; PR 2001/176; IT 360

Subject references:
- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

Legislative references:
- TAA 1953 Part IVAAA
- ITAA 1936 Div 3 of Part III

- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- I TAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
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- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
- ITAA 1936 82KZMG(5)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
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- ITAA 1997 Div 35
- ITAA 1997 35-10
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- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
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- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
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- ITAA 1997 Div 328
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- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- Copyright Act 1968

Case references:

- FCT v. Lau 84 ATC 4929; (1984) 16 ATR 55

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