



PR 2002/96 - Income tax: New World Project 2002

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 June 2002*



Product Ruling

Income tax: New World Project 2002

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

Preamble

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

No guarantee of commercial success

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

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how 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.

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 the 'New World Project 2002', 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 70 (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 'Member') 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 'Members'.

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. Members who elect to market their own produce are excluded from the class of persons to whom this Ruling applies (see paragraphs 43 and 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.

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apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

12. This Ruling applies prospectively from 26 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 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the 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.

Arrangement

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

- Applications for Product Ruling dated 22 March 2002 and 2 May 2002;
- Draft Product Disclosure Statement for the New World Project 2002, undated, received 11 June 2002;

- Draft Constitution of the New World Project 2002, received 22 May 2002;
- Draft **Lease and Management Agreement** for the New World Project 2002 between New World RE Ltd (the 'Responsible Entity'), New World Management Pty Ltd (the 'Manager') and each Member, received 11 June 2002;
- Draft Custody Agreement between New World Capital Ltd ('Custodian') and New World RE Ltd (the 'Client'), received 3 May 2002;
- Draft Compliance Plan for the New World Project 2002, received 3 May 2002; and
- Additional correspondence dated 22 May 2002, 30 May 2002, 10 June 2002, 11 June 2002 and 17 June 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.

16. The documents highlighted are those that Members 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 Member, or any associate of a Member, will be a party to, which are a part of the arrangement to which this Ruling applies.

17. 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

18. The salient features of the arrangement for the New World Project 2002 are as follows:

Location	The north-eastern region of New South Wales.
Type of business each participant is carrying on	Commercial growing and cultivation of: <ul style="list-style-type: none"> • Hardwood trees for the purpose of harvesting and selling timber; and • An annual crop for the purpose of production and sale.
Number of hectares offered for cultivation	Approximately 190 hectares initially but additional land may be acquired.

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Size of each interest (Unit)	$\frac{5}{6}$ hectare comprising $\frac{1}{2}$ hectare for Hardwood trees (Forest Lot) and $\frac{1}{3}$ hectare for cropping (Crop Lot).
Minimum subscription	100 Units
Number of trees established per hectare	1,200 Hardwood trees planted, guaranteed survival rate of 90%.
Expected production	A yield of between 17 and 23m ³ of clear wood per hectare is forecast.
The term of the Project	Approximately 20 years.
Initial cost	\$5,830
Initial cost per hectare	\$6,996
Ongoing and other costs	Rent and Management fees. Variable costs charged on a recovery basis. Harvesting and marketing fees. Success Fee.

19. The Project will be registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is New World RE Ltd. The Manager is New World Management Pty Ltd ('the Manager'). The Project will be conducted on land in north-eastern New South Wales. The Project will initially commence on land known as 'Rangeview' being:

- Lots 19 and 94 in Deposit Plan 751059 at Woodenbong in the Shire of Kyogle, Parish of Donaldson and County of Buller.

20. The Lease and Management Agreement provides for an area of land called a 'Unit' to be sub-let to the Member for a term of approximately 20 years. Each Unit is approximately $\frac{5}{6}$ hectare and is comprised of a Forest Lot of $\frac{1}{2}$ hectare for the production of Hardwood trees and a Crop Lot of $\frac{1}{3}$ hectare for the production of annual crops.

21. There is a minimum subscription of 100 Units for this Project. Approximately 190 hectares, representing 227 Units, are available at Rangeview under this offer. Additional land may be acquired for the Project. All Project land will be assessed by an independent expert as suitable for the purposes of the Project.

22. Under this offer, Members may enter the Project in consecutive financial years. However, this Ruling will be restricted to participants entering the Project in either the 2001/2002 income year

(defined for the purposes of this Ruling as ‘2002 Members’) or the 2002/2003 income year (‘2003 Members’).

23. Members enter into a contract with the Manager for the management of their Unit. The Manager will be responsible for establishing and cultivating the trees and the crop and the harvesting, processing and sale of the produce. Members may elect to harvest and sell their own produce or the Manager will do so on their behalf.

24. Tree thinning will commence after approximately 4 years. A further thinning after 9 years is expected to produce a small commercial quantity of wood produce. The remaining trees will be harvested towards the end of the Project and processed to rough sawn timber lengths. The Crop will be an annual crop and harvesting will take place each year.

25. Upon application, Members will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required.

Constitution

26. The Constitution establishes the Project and operates as a deed binding on all of the Members and the Responsible Entity. The Constitution sets out the terms and conditions under which New World RE Ltd agrees to act as the Responsible Entity and manage the Project. The Lease and Management Agreement will be executed on behalf of a Member following the acceptance of their signed Application Form from the Product Disclosure Document. Members are bound by the Constitution by virtue of their participation in the Project.

27. The Responsible Entity will:

- prepare a Lease and Management Agreement after acceptance of an application (clause 6);
- maintain a register of Members (clause 27); and
- distribute profits (clause 30).

28. Under the terms of the Constitution, all moneys received from applications shall be deposited into an Application Fund. The Application Moneys will be released when the Responsible Entity is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 7 and 8 of the Constitution).

Compliance Plan

29. New World RE Ltd has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the

Responsible Entity meets its obligations and responsibilities contained in the Constitution and that the interests of Members are protected.

Lease and Management Agreement

30. The owner of the land, New World Capital Ltd, has agreed to lease an area of land to the Manager, New World Management Pty Ltd, in order to conduct the Project. The Manager is entitled to use the land for the purposes of the Project and to sub-lease the land to Members.

31. Members participating in the arrangement will enter into a Lease and Management Agreement with the Responsible Entity and the Manager. Members are granted an interest in land in the form of a sub-lease to use their leased area, comprising one or more Units, for the purpose of cultivating and harvesting an annual crop and Hardwood trees. The term of the agreement is approximately 20 years when the final distribution of the sales proceeds is made to the Member or until the Project is terminated, if earlier.

32. Each Member must pay Rent to the Manager during the term of the Project in an amount specified at Item 2 of Schedule 2 to the Lease and Management Agreement.

33. Pursuant to the terms of the Lease and Management Agreement, the Responsible Entity and the Member appoint the Manager to perform services specified in the agreement (clause 6.6). The services are specified in Schedule 1 of the Lease and Management Agreement and include, but are not limited to, the provision of the following:

Item 1 Initial Services – Forest Lots

- procure seedlings;
- tend tree seedlings as required in respect of planting on the Member's Forest Lots;
- take all necessary steps to control weeds and vermin on the Member's Forest Lots in respect of planting and establishing trees;
- rip and mound the Member's Forest Lots;
- plant the tree seedlings; and
- apply fertilisers as required in respect of planting on the Member's Forest Lots.

Item 2 Initial Services – Crop Lots

- procure seed for cropping on the Member's Crop Lots;

- take all necessary steps to control weeds and vermin prior to establishing crops;
- sow the seeds;
- apply fertilisers as required in respect of planting on the Member's Crop Lots; and
- undertake secondary weed control of the Member's Crop Lots as required.

Item 3 Ongoing Services

- manage the Forest Lots and Crop Lots and employ appropriate personnel for that purpose;
- use all reasonable measures to exterminate and keep the Lots free from rabbits, vermin and other pests;
- make applications of fertiliser and control weeds in accordance with good tree cropping and farming practices as appropriate;
- maintain access roads and firebreaks;
- monitor markets for plantation grown timber of the species planted in the timber Plantations and for crops grown in the crop Plantations;
- liaise with purchasers of timber and (as appropriate) processors and operators of port facilities as to access to markets; and
- liaise with purchasers of crop produce as appropriate to secure sales of that produce.

Item 4 Pruning Services

- approximately 4 years after the Commencement Date the Responsible Entity will inspect the Member's Forest Lots and if required, prune the Tree Crop.

Item 5 Harvesting and Marketing Services

- plant, manage, harvest and market a Crop on an annual basis or as required;
- arrange thinning of the Member's Tree Crop, where required;
- arrange the Clear Felling of the Member's Tree Crop; and
- arrange the sale of the timber produce.

Fees

34. Fees are payable under the Lease and the Management Agreement on a per Unit basis. The total of the fees payable on Application is \$5,830 represented as:

- Initial Services Fee of \$4,697 for the Forest Lot payable for Initial Services to be performed during the Initial Period, being the 12 month period from and including the Commencement Date; and
- Initial Services Fee of \$1,133 for the Crop Lot payable for Initial Services to be performed during the Initial Period.

35. Amounts payable in subsequent years are as follows:

- Management Fee of \$330 per annum (CPI indexed) payable in advance on or before 30 June of each year after the Initial Period;
- Rent of \$275 per annum (CPI indexed) payable in arrears on or before 30 June of each year after the Initial Period;
- Variable costs in relation to Forest Lots for insurance, thinning, pruning and other forestry costs payable in arrears on or before 30 June each year after the Initial Period;
- Variable costs in relation to Crop Lots for insurance, fertilising, sowing, harvesting, weed and pest control and all other related cropping costs payable in arrears on or before 30 June each year after the Initial Period;

36. The Member is also required to pay the following amounts that will be deducted from the sales proceeds:

- an amount equal to 3.3% of the Net Sales Proceeds before Management Fees for each Unit in consideration for providing the Harvesting and Marketing Services (clause 7.3 and Item 3 of Schedule 2);
- with respect to the Forest Lot, a Success Fee equal to 55% of the amount by which the actual Net Sales Proceeds exceed the projected Net Sales Proceeds set out in the Product Disclosure Document (clause 7.4 and Item 4 of Schedule 2).
- with respect to the Crop Lot, a Success Fee equal to 55% of the excess over \$300 of the amount by which the Crop income exceeds the costs associated with both

the Forest and the Crop (clause 7.4 and Item 4 of Schedule 2).

37. The Manager will maintain a public risk insurance policy in respect of the Plantation and such additional insurance, including fire insurance, as in the opinion of the Responsible Entity is warranted and readily available at a commercial cost. The Member will bear the cost of insurance (sub-clause 5.9(b) of the Lease and Management Agreement).

Planting

38. Under the Lease and Management Agreement, the Manager will supply the necessary seedlings for the Forest Lots and seed for the Crop Lots. The Manager will be responsible for planting the seedlings and sowing the seed on the Lots.

39. Each Forest Lot will be planted with approximately 600 Hardwood seedlings. The species to be planted will vary according to an assessment of each site based on soil types, aspect, topography and climate. The species recommended by the Manager for the Rangeview property are *Eucalyptus dunnii* (Dunn's White Gum) and *Eucalyptus mollucana* (Grey Box) in a ratio of 90% and 10% respectively.

40. The Responsible Entity will conduct a survival count of seedlings 12 months after planting. The Responsible Entity covenants to replace seedlings on a Forest Lot which have died to achieve a maximum of 90% of the initial stocking rate as soon as practicable thereafter and at its own cost.

41. The Product Disclosure Statement states that the Manager will not limit the type of Crop that will be grown to a specific type and will research and monitor prevailing conditions in an effort to select crops that will give benefits to Members.

42. The Crops initially selected are the Adzuki bean, Barley and Maize. Adzuki beans are sown in January and harvested approximately 100 days later in April. Barley will be planted as a winter crop. Maize will be planted every fourth summer as a rotational crop.

Harvesting and Sale

43. Upon Application, Members may elect to be a 'Non-participating Member' and personally market the produce grown on their Lots (clauses 10.1 and 10.12). This Ruling does not apply to Members who make such an election.

44. The Responsible Entity will sell the timber and crop produce harvested on behalf of the Members who do not make such an election ('Participating Members') by entering into an agreement that is in the best interests of the Member (clauses 10.4 and 10.14).

45. The harvest of the Forest Lots will take place at an appropriate time determined by the Responsible Entity but is expected to take place in the final year of the Project. Crops will be harvested annually commencing in the year ending 30 June 2003.

46. The Gross Sales Proceeds from the produce of Participating Members will be paid direct to the Responsible Entity. The Responsible Entity is authorised to retain the costs, indemnities, Management Fees and Rent as set out in clause 10.9 of the Lease and Management Agreement. Participating Members will share the Net Sales Proceeds according to their Proportional Interest in the Project. The term 'Proportional Share' is defined in clause 1 of the Lease and Management Agreement.

Finance

47. Members can fund their investment in the Project themselves or borrow from an independent lender.

48. This Ruling does not apply if a Member 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 are involved in the provision of finance for the Project.

Ruling

Application of this Ruling

49. This Ruling applies only to Members who are accepted to participate in the Project:

- on or before 30 June 2002 where the Member has executed a Lease and Management Agreement on or before that date (2002 Members); and/or
- on or after 1 July 2002 and on or before 30 June 2003, where the Member has executed a Lease and Management Agreement on or between those dates (2003 Members).

50. The Member's participation in the Project must constitute the carrying on of a business of primary production. This Ruling does not apply to Non-participating Members who elect to personally market produce produced from their Unit(s).

Minimum Subscription

51. A Member is not eligible to claim any tax deductions until the Member's application to enter the Project is accepted and the Project has commenced. Under the terms of the Product Disclosure Statement, a Member's application will not be accepted and the Project will not proceed until the minimum subscription of 100 units is achieved.

The Simplified Tax System ('STS')

Division 328

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

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

Qualification

53. This Product Ruling assumes that a Member who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Member may become an 'STS taxpayer' at a later point in time. Also, a Member 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 Members that cannot be accommodated in this Ruling. Such Members can ask for a private ruling on how the taxation legislation applies to them.

Prepaid expenditure for Management Fees***Sections 82KZME and 82KZMF***

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

- \$1,133 Initial Services Fee per Crop Lot; and
- annual Management Fees of \$330 (indexed) for the term of the Project.

55. In this context, a prepayment refers to advance expenditure incurred by a Member 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 Member prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Member must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii) at paragraph 65 below).

56. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Member 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.

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

57. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 97 to 102.

Prepaid expenditure for ‘seasonally dependent agronomic activities’***Section 82KZMG***

58. 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 103 to 107.

59. 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.

60. Section 82KZMG only applies to an agreement for the planting and tending of trees for the purpose of felling. Under the Lease and Management Agreement, for each Unit, a Member incurs \$4,697 for ‘seasonally dependent agronomic activities’. This expenditure is deductible in the income year that the Member incurs this amount.

Tax outcomes for Members who are not ‘STS taxpayers’**Assessable Income*****Section 6-5***

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

62. The Member recognises ordinary income from carrying on the business of agriculture at the time that income is derived.

Trading Stock***Section 70-35***

63. A Member who is not an ‘STS taxpayer’ may, in some years, hold crop produce that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Member must include the amount of that excess in assessable income.

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64. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Member may claim the amount of that excess as an allowable deduction.

Deductions for Management Fees and Rent***Section 8-1***

65. A Member 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 Tables on a per Unit basis.

2002 Members

Fee Type	ITAA 1997 Section	Year ended 30/06/2002	Year ended 30/06/2003	Year ended 30/06/2004
Initial Services Fee – Forest Lot	8-1	\$4,697 See Notes (i) & (ii) below		
Initial Services Fee – Crop Lot	8-1	Amount must be calculated – See Notes (i) and (iii) below		
Management Fees	8-1		Amount must be calculated – See Notes (i) and (iv) below	Amount must be calculated – See Notes (i), (iv) & (vi) below
Rent	8-1		\$275 – See Notes (i) and (v) below	\$275 (indexed) – See Notes (i), (v) & (vi) below
Variable Costs (to be advised by Manager)	8-1		Amount must be calculated – See Notes (i) and (v) below	Amount must be calculated – See Notes (i) and (v) below

2003 Members

Fee Type	ITAA 1997 Section	Year ended 30/06/2003	Year ended 30/06/2004	Year ended 30/06/2005
Initial Services Fee – Forest Lot	8-1	\$4,697 See Notes (i) & (ii) below		
Initial Services Fee – Crop Lot	8-1	Amount must be calculated – See Notes (i) and (iii) below		
Management Fees	8-1		Amount must be calculated – See Notes (i) and (iv) below	Amount must be calculated – See Notes (i), (iv) & (vi) below
Rent	8-1		\$275 – See Notes (i) and (v) below	\$275 (indexed) – See Notes (i), (v) & (vi) below
Variable Costs (to be advised by Manager)	8-1		Amount must be calculated – See Notes (i) and (v) below	Amount must be calculated – See Notes (i) and (v) below

Notes:

- (i) If the Member 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 132.
- (ii) The Initial Services Fee – Forest Lot is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the year in which it is incurred.
- (iii) The Initial Services Fee – Crop Lot is **NOT** deductible in full in the year incurred. The deduction for each year’s fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 56). Members can calculate the number of days in the ‘eligible service period’ in the first expenditure year by reference to the

Commencement Date. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 133).

- (iv) Although the Lease and Management Agreement requires the annual Management Fee to be prepaid, for a Member who acquires the minimum allocation, the amount of the prepaid fee 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 Member who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 134). However, where a Member acquires a number of Units in the Project, the amount of the Member's prepaid Management Fee may be \$1,000 or more. Such Members **MUST** determine the deduction for the prepaid Lease fee on the same basis as the prepaid Management fees, i.e., using the formula shown above in paragraph 56.
- (v) Rent and Variable Costs are deductible in full in the year that they are incurred. However, if a Member **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 56 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.
- (vi) Rent and Management Fees are subject to indexation. The amount will be the prior year fee indexed at the annual rate of inflation.

Tax outcomes for Members who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

66. That part of the gross sales proceeds from the Project attributable to the Member's produce, less any GST payable on those

proceeds (section 17-5), will be assessable income of the Member under section 6-5.

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

Treatment of trading stock

Division 70 and section 328-285

68. A Member who is an 'STS taxpayer' may, in some years, hold crop produce that will constitute trading stock on hand. Where, for such a Member, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

69. Alternatively, a Member who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Management Fees and Rent

Section 8-1 and section 328-105

70. A Member who is an 'STS taxpayer' may claim tax deductions for the revenue expenses in the following Tables on a per Unit 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 Member who is an 'STS taxpayer', then the amount is only deductible to the extent to which it has been paid, or has been paid for the Member. 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.

PR 2002/96**2002 Members**

Fee Type	ITAA 1997 Section	Year ended 30/06/2002	Year ended 30/06/2003	Year ended 30/06/2004
Initial Services Fee – Forest Lot	8-1	\$4,697 See Notes (vii) & (viii) below		
Initial Services Fee – Crop Lot	8-1	Amount must be calculated – See Notes (vii) and (ix) below		
Management Fees	8-1		Amount must be calculated – See Notes (vii) and (x) below	Amount must be calculated – See Notes (vii), (x) & (xii) below
Rent	8-1		\$275 – See Notes (vii) and (xi) below	\$275 (indexed) – See Notes (vii), (xi) & (xii) below
Variable Costs (to be advised by Manager)	8-1		Amount must be calculated – See Notes (vii) and (xi) below	Amount must be calculated – See Notes (vii) and (xi) below

2003 Members

Fee Type	ITAA 1997 Section	Year ended 30/06/2003	Year ended 30/06/2004	Year ended 30/06/2005
Initial Services Fee – Forest Lot	8-1	\$4,697 See Notes (vii) & (viii) below		
Initial Services Fee – Crop Lot	8-1	Amount must be calculated – See Notes (vii) and (ix) below		
Management Fees	8-1		Amount must be calculated – See Notes (vii) and (x) below	Amount must be calculated – See Notes (vii), (x) & (xii) below
Rent	8-1		\$275 – See Notes (vii) and (xi) below	\$275 (indexed) – See Notes (vii), (xi) & (xii) below
Variable Costs (to be advised by Manager)	8-1		Amount must be calculated – See Notes (vii) and (xi) below	Amount must be calculated – See Notes (vii) and (xi) below

Notes:

- (vii) If the Member 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 132.
- (viii) The Initial Services Fee – Forest Lot is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the year in which it is paid.
- (ix) The Initial Services Fee – Crop Lot is **NOT** deductible in full in the year in which it is paid, or is paid for the Member. The deduction for each year’s fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 56). Members can calculate the number of days in the ‘eligible service period’ in the first expenditure year by reference to the

Commencement Date. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 133).

- (x) Although the Lease and Management Agreement requires the annual Management Fee to be prepaid, for a Member who acquires the minimum allocation, the amount of the prepaid fee 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 Member who is an 'STS taxpayer', is deductible in full in the year in which it is paid (see Example 3 at paragraph 134). However, where a Member acquires a number of Units in the Project, the amount of the Member's prepaid Management Fee may be \$1,000 or more. Such Members **MUST** determine the deduction for the prepaid Lease fee on the same basis as the prepaid Management fees, i.e., using the formula shown above in paragraph 56.
- (xi) Rent and Variable Costs are deductible in full in the year that they are paid. However, if a Member **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 56 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.
- (xii) Rent and Management Fees are subject to indexation. The amount will be the prior year fee indexed at the annual rate of inflation.

Tax outcomes that apply to all Members

Interest

71. The deductibility or otherwise of interest incurred by Members who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Members who borrow funds in order to participate in the

Project, should read the discussion of the prepayment rules in paragraphs 95 to 102 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Member's choice.

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

Section 35-55 - Commissioner's discretion

72. For a Participating Member who is an individual and who enters the Project during the years ended 30 June 2002 or 30 June 2003, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for 2002 Members, for the income years ending 30 June 2002 to 30 June 2006, 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 2003 Members, the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2007, 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.

73. 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;
- a Member's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Member'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)).

74. Where the 'exception' in subsection 35-10(4) applies, or the Member'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 Member 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.

75. Members are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Members 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

76. For a Member who participates in the Project and incurs expenditure as required by the 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 Member carrying on a business?

77. For the amounts set out in the Tables above to constitute allowable deductions the Member's agricultural activities as a participant in New World Project 2002 must amount to the carrying on of a business of primary production.

78. Where there is a business, or a future business, the gross proceeds from the sale of timber or crops 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.

79. For schemes such as that of New World Project 2002, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Member'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.

80. Generally, a Member will be carrying on a business of agriculture, and hence primary production, if:

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

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

81. In this Project each Member enters into a Lease and a Management Agreement.

82. Under the agreement each individual Member will have rights over a specific and identifiable area of at least $\frac{5}{6}$ hectares of land. The agreement provides the Member with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the agreement the Member must use the land in question for the purpose of carrying out agricultural activities, and for no other purpose. The agreement allows the Manager to come onto the land to carry out its obligations.

83. Under the agreement the Manager is engaged by the Member to establish and maintain the Member'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 Member's behalf.

84. The Manager is also engaged to harvest and sell, on behalf of the Member, the timber and crops grown on the Member's Unit(s).

85. 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.

86. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Member in the Project will derive assessable income from the sale of timber and crops 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.

87. The pooling of produce grown on the Member's Unit(s) with the produce of other Members is consistent with general agricultural practices. Each Member's proportionate share of the sale proceeds of the pooled timber will reflect the proportion of the trees or crop contributed from their Unit(s).

88. The Manager's services are also consistent with general silvicultural and farming practices. They are of the type ordinarily found in agricultural ventures that would commonly be said to be businesses. While the size of a Unit is relatively small, it is of a size

and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

89. The Member's degree of control over the Manager as evidenced by the Lease and Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Member with regular progress reports on the Member's Units and the activities carried out on the Member's behalf. Members are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

90. The agricultural 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 Member's agricultural activities in the New World Project 2002 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

91. Subdivision 328-F sets out the eligibility requirements that a Member must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

92. The question of whether a Member is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Member 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

93. Consideration of whether the lease fees (Rent) 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.

94. The Rent and Management Fees associated with the agricultural activities will relate to the gaining of income from the Member's business of agriculture (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber and crops) 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 Initial Services 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

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

96. 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

97. 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 101 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)).

98. 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.

99. 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 Member in this Project who, in order to participate in the Project may borrow funds from a third party financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Member prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

100. There are a number of exceptions to these rules, but for Members 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 Members in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

101. 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.

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

102. 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

103. 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).

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

- incurred on or after 2 October 2001 and on or before 30 June 2006;
- 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.

105. To satisfy subsection 82KZMG(3) the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling;
- 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.

106. 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.

107. 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

Initial Services Fee – Forest Lot

108. Under the Lease and Management Agreement, a Member incurs an Initial Services Fee of \$4,697 for the Forest Lot. The fee for the Forest Lot consists 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'.

109. A Member entering the Project who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the Forest Lot component of the Initial Services Fee in the income year in which the fee is paid. A Member who is not an 'STS taxpayer' can claim an immediate deduction for the Forest Lot Initial Services Fee in the income year in which the fee is incurred.

Initial Services Fee – Crop Lot and Management Fees

110. The Lease and Management Agreement also requires that a Member incurs an Initial Services Fee of \$1,133 for the Crop Lot and Management Fees for each year of the Project, commencing in Year 1 with an amount of \$330 for the performance of ongoing services during the term of the Project.

111. 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.

112. The prepaid Management Fee for each year, 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 Member who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant Management Fees in the income year in which the fee is paid. A Member who is not an 'STS taxpayer' can claim an immediate deduction for each of the relevant Management Fees in the income year in which the fee is incurred.

113. However, where a Member acquires more than the minimum allocation of one Unit in the Project and the quantum of the prepaid Management 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).

Members who choose to pay fees for a period in excess of that required by the Project's agreements

114. Although not required under the Lease and Management Agreement, a Member participating in the Project may choose to prepay Rent, fees or interest for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 113 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

116. 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.

117. 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.

118. 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.

119. 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 Members who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

120. 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).

121. A Member 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 Participating Member 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 2006. Members 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.

122. 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 Member's participation in the Project.

123. 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.

124. Information provided with this Product Ruling indicates that a 2002 Member who is a Participating Member and 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 income year commencing 30 June 2007. Similarly, a 2003 Member who is a Participating Member and 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 income year commencing 30 June 2008.

125. The Commissioner will decide for such a 2002 Member 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 2006, or 30 June 2007 for 2003 Members.

126. This Product Ruling is issued on a prospective basis (i.e., before an individual Member'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 72) in the manner described in the Arrangement (see paragraphs 15 to 48). 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.

127. 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 Independent Cropping Report and report of the Independent Forester, plus additional evidence provided with the application by the Responsible Entity; and
- independent, objective and generally available information relating to the plantation timber and farming industries which substantially support cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Section 82KL

128. 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

129. 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).

130. The New World Project 2002 will be a ‘scheme’ commencing with the issue of the Product Disclosure Statement. A Member will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 65 and 70 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.

131. Members 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 Members 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

132. 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

133. 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:

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

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

= **\$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’

134. 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 Unit. 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 Unit 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.

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Commissioner of Taxation

26 June 2002

<i>Previous draft:</i>	- ITAA 1936 82KZME
Not previously issued in draft form	- ITAA 1936 82KZME(1)
	- ITAA 1936 82KZME(2)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZME(3)
IT 360; TR 92/1; TR 92/20;	- ITAA 1936 82KZME(4)
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- advance deductions and expenses	- ITAA 1936 82KZMG(1)
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- carrying on a business	- ITAA 1936 82KZMG(3)
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