



PR 2003/29 - Income tax: TFS Gold Card Sandalwood Project 2003

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 This document has changed over time. This is a consolidated version of the ruling which was published on *28 June 2006*



Product Ruling

Income tax: TFS Gold Card Sandalwood Project 2003

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Preamble

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

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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 'TFS Gold Card Sandalwood Project 2003', or just simply as 'the Project'.

Tax law(s)

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);
- Part 3-1 (ITAA 1997);
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Sections 82KZME - 82KZMF (ITAA 1936);
- Section 82KZMG (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e. being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

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

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 28 May 2003, 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 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).

Note: The Addendum to this Ruling that issued on 28 June 2006 applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. 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

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

- Application for Product Ruling as constituted by documents dated 25 February 2003 and 24 March 2003 plus additional correspondence dated 27 March 2003, 1 April 2003, 8 April 2003, 1 May 2003, 5 May 2003, 6 May 2003 and 12 May 2003;
- Draft Information Memorandum to be issued by Tropical Forestry Services Ltd ('Manager'), dated 28 February 2003;
- **Draft Head Lease between T.F.S. Properties Ltd and the Grower, received 27 March 2003;** and
- **Draft Management Agreement between Tropical Forestry Services Ltd and the Grower, received 27 March 2003.**

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

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

16. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

- (a) the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*; or
- (b) not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001*.

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17. Each of these categories is explained in paragraphs 73 to 80 in the Explanations area of this Product Ruling.

Overview

18. The salient features of the TFS Gold Card Sandalwood Project 2003 arrangement are as follows:

Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of Indian Sandalwood (<i>Santalum album</i>) Trees for the purpose of harvesting and selling timber.
Number of hectares available for cultivation under this offer	100
Size of each leasehold area	5 hectares
Number of Sandalwood Trees per hectare	416
The term of the Project	15 years
Initial cost	\$214,500
Initial cost per hectare	\$42,900
Ongoing costs	Lease and Management Fees (may be prepaid or paid annually). Harvesting costs, Costs of Sale and Incentive Fees payable from harvest proceeds. Optional insurance premiums

19. The Project is not a registered managed investment scheme under the *Corporations Act 2001*. Tropical Forestry Services Ltd will be the Manager of the Project. Growers participating in the arrangement will enter into a Management Agreement and either a lease or purchase arrangement. The arrangement provides for Growers to either purchase land outright or lease a portion of the 'Project Land' near the Ord River in Kununurra, Western Australia described as:

- King Location 385 being the whole of the land contained in Certificate of Title Volume 1890 Folio 718.

20. This offer pertains to 100 hectares representing 20 Sandalwood Lots. There is no minimum subscription for the Project. The Manager is able to accept oversubscriptions to the extent that the Lessor has suitable irrigated land available. Additional land will only be procured if deemed suitable by an Independent Forester.

21. A Grower will either purchase land or lease a portion of land for a period of approximately 15 years. The land will be known as the Grower's 'Plantation' and will be made up of one or more 'Sandalwood Lots' up to a maximum of 10 Lots. Each Sandalwood Lot is 5 hectares and will be planted with sufficient Sandalwood seedlings and host plants or Trees to reasonably provide a survival rate of 416 Sandalwood trees per hectare approximately 12 months after planting. The Sandalwood Lots are separately identified by a reference number on a plan of the plantation annexed to the agreement. Growers will receive a certificate for the Sandalwood Lots acquired.

22. Under this offer, Growers may enter the Project in different financial years. This Ruling only applies to Growers who enter the Project as described below. Depending on the date of acceptance of a Grower's application, a Grower will be, for the purpose of this Ruling, either a '2003 Grower', a 'Pre-paid 2003 Grower' or a '2004 Grower'. The Manager will determine into which category it will allocate Growers, having regard to its ability to schedule the completion of the Establishment Services in any given year (see paragraphs 42 to 47).

23. The Manager is responsible for establishing and cultivating the Trees and the harvesting of the timber. Harvesting of the Trees is expected to be completed in the 15th year. The Manager will sell the produce on behalf of Growers.

24. Upon application, Growers will execute a Power of Attorney enabling the Manager, Tropical Forestry Services Ltd, to act on their behalf as required.

Interest in Land

25. Growers can choose to either purchase land for this Project or lease a portion of land. A portion of the Project Land can be purchased or Growers can purchase land at another location in the Ord River Irrigation Area that has been deemed suitable for the commercial growing of Sandalwood trees by the Forestry Expert.

26. Growers entering the Project in the 2003 Year, where land is to be purchased for the Project, will be treated as Pre-Paid 2003 Growers unless the sale of the land can be finalised in time for the Establishment Services to be completed by 30 June 2003.

27. Growers that lease the land will enter into a Lease Agreement with TFS Properties Ltd. These Growers are granted an interest in land in the form of a lease to use their Leased Area, comprising one or more Sandalwood Lots, for the purpose of conducting their afforestation business until the final distribution of the sale proceeds is made to the Grower or until the Project is terminated.

28. Other than the Establishment Period, each Grower that leases land must pay rent to the Lessor for each year of the Project being an amount specified in Clause 3.1 of the Lease Agreement.

29. The conditions of the Lease are outlined in Clause 5 of the Agreement. Some of the conditions of the Lease are that the Grower:

- will not permit the Leased Area to be used for a purpose other than that of commercial silviculture of Sandalwood Trees;
- will not use the Leased Area for residential, recreational or tourist purposes; and
- will not install or remove any fixtures, fittings or improvements except with the approval of the Lessor.

Management Agreement

30. Growers participating in the Project will enter into a Management Agreement with Tropical Forestry Services Ltd as Manager.

31. The Management Agreement provides that each Grower appoints the Manager to perform services under the Agreement. The services to be performed are specified in the definitions of 'Establishment Services', 'Ongoing Services' and 'Selling and Marketing Services' which are listed respectively at Items 4, 5 and 6 of the Schedule. The Manager will supervise and manage all silvicultural activities on behalf of each Grower including, but not limited to, the provision of the following services:

Establishment Services

- acquire appropriate seeds and seedlings;
- carry out weed control, surveying and ground preparation of the Plantation;
- plant on the Plantation, in accordance with good silvicultural and forestry practices, sufficient Sandalwood seedlings or trees;
- plant on the Plantation other trees as it may consider to be necessary to enable or encourage the growth of the Sandalwood seedlings or trees; and
- irrigate, cultivate, tend, cull, prune, fertilise, replant, spray, as required in support of planting.

Ongoing Services

- irrigate, cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the Trees;
- maintain the Plantation according to good silvicultural and forestry practices;
- carry out or arrange to be carried out the harvesting and processing of the Trees; and
- keep access roads, firebreaks and the Plantation in good repair and free from vermin.

Fees

32. Management Fees and Lease Fees, where the Grower does not purchase land, are payable by the Grower for each Sandalwood Lot.

33. No Rent is payable in respect of the Establishment Period. An Establishment Fee of \$214,500 is payable on application for the Establishment Period.

34. There are 2 payment options for management fees and lease fees, if applicable, which are payable for the balance of the term of the Project after the Establishment Period. This ruling has no application where a Grower enters into an arrangement to pay fees other than pursuant to the two options set out below in paragraphs 35 to 39. Unless the Grower elects to prepay fees at the time of application, they will be deemed to have elected to pay fees annually.

Option 1 - Annual Lease (if applicable) and Management Fees

35. For the financial year immediately following the Establishment Period, referred to as Year One, a management fee of \$66,000 is payable for each Sandalwood Lot. This Fee is payable in two equal instalments on 1 July and the following 1 January of the Year.

36. For each financial year commencing after Year One, a management fee of \$28,050 (indexed) per Sandalwood Lot is payable in consideration of the Manager performing the Ongoing Services under Item 5 of the Schedule to the Management Agreement.

37. The fee will be indexed in each subsequent year at the greater of 2.5% per annum or the annual rate of inflation. The management fees are payable in two equal instalments on each 1 July and 1 January during the term of the Project. The Manager will advise the Grower of the amount payable before the due date.

38. Where Growers lease their land, rent is payable by the Grower to the Lessor for each year of the Project commencing from Year One. The amount will be set at \$6,600 per Sandalwood Lot in Year One and indexed in each subsequent year at the greater of 2.5% per annum or the annual rate of inflation. Rent is payable in two equal instalments on each 1 July and 1 January during the term of the Project.

Option 2 - Prepayment of Fees

39. Growers may elect on application to prepay all annual management fees and lease fees, where land is leased, due for the life of the Project after the Establishment Period. Under this option, one payment of \$330,000 per Sandalwood Lot, where the land is leased, must be paid at the time of application which represents:

- Rent of \$82,500 (payable only where land is leased); and
- Management fees of \$247,500.

Other Fees

40. The Grower is also required to pay the following amounts to the Manager:

- the Grower's share of the costs of harvest, processing and land restoration;
- a Selling and Marketing Fee, if applicable (see paragraph 51 below), equal to 5.5 % of the gross proceeds of sale; and
- an Incentive Fee of an amount equal to 27.5% of the excess of the net proceeds of sale per Sandalwood Lot over the amount estimated by the Manager.

41. The Manager will insure the Plantation against fire until the end of the Establishment Period. Thereafter, the Manager will arrange insurance of the Plantation on behalf of the Grower, if so requested, to cover against fire and other usual risks. The cost of such insurance, plus 5.5%, will be payable by the Grower to the Manager.

Establishment Services

42. The Manager will execute the Lease Agreement, where land is leased for the Project, and the Management Agreement according to its ability to complete the Establishment Services, which are to be provided during the Establishment Period.

43. Where an application is accepted on or before 15 June in any financial year, the Establishment Period will be the period from the Commencement Date to 30 June of the same financial year (2003 or 2004 Growers).

44. Where an application is accepted after 15 June in any financial year, in circumstances where the Manager considers that the Establishment Services can be performed on or before the following 30 June and if the Establishment Services are performed on or before that 30 June - the Establishment Period is the period from the Commencement Date to that 30 June (2003 or 2004 Growers).

45. Where an application is accepted at any time after 15 June in any financial year, in circumstances where the Manager exercises its discretion to accept the relevant Application but does not intend that the Establishment Services be performed on or before the following 30 June - the Establishment Period is the period from the next 1 July until the following 30 June (Pre-paid Growers).

46. From 15 June of each year the Manager will be monitoring on a daily basis its ability to complete the Establishment Services by 30 June of that year. Where the Manager receives an application during this period and considers that the Establishment Services cannot be completed by 30 June, the Manager may exercise its discretion to accept the Grower as a Pre-paid Grower.

47. During the Establishment Period the Manager will be responsible for planting Sandalwood seedlings or trees on the Timber Lots at a rate which would reasonably be expected to provide a survival rate of 416 Sandalwood trees per hectare at the end of the First Period. The Manager will also plant other trees (hosts) required to encourage the growth of the Sandalwood seedlings or trees during the Establishment Period.

Harvesting and Sale

48. Harvesting and processing must be completed before 31 December in the 17th year after commencement of the Project. The Manager must harvest and process or procure a suitably qualified person to harvest and process the Trees at market rates in accordance with a Harvest Plan. The Harvest Plan is based on when the Sandalwood trees are expected to achieve a heartwood content of 30kg per tree. Although the Harvest Plan may be amended, harvesting is expected to be undertaken according to the following schedule:

- Year 13 15% of the Plantation;
- Year 14 30% of the Plantation; and
- Year 15 55% of the Plantation.

49. At all times the Grower has full right, title and interest in the Forest Produce and the right to have the Forest Produce sold for their benefit (clause 7.1). The Manager is irrevocably appointed to sell the Forest Produce at the maximum practicable price available on behalf of all Growers (clause 8.1 and Item 6).

50. The Manager will harvest and market the Forest Produce on behalf of each Grower individually. The Forest Produce will not be pooled with Forest Produce harvested from the Plantations of other Growers and the Gross Proceeds of Sale will not form part of a common Proceeds Fund. Accordingly, the Gross Proceeds of Sale for each Grower will reflect the return from the Forest Produce actually harvested from that Grower's Plantation.

51. The Gross Proceeds of Sale from the Forest Produce from the Grower's Plantation will be paid direct to the Manager. As soon as practicable after receiving the Gross Proceeds of Sale for the Grower, the Manager must pay to itself the costs incurred for harvesting, processing, marketing and selling (clause 9.1) each Grower's individual Forest Produce. As soon as practicable after making the above payments, the Manager will pay to itself any other fees or amounts owing and distribute the remainder to the Grower (clause 9.2).

Finance

52. Growers may fund their participation in the Project themselves or borrow from an independent lender. The Manager has provided a written assurance that an application will not be accepted if that acceptance is subject to finance being approved. Accordingly, this Ruling will not apply to any Grower whose application, contrary to this written assurance, is accepted subject to finance being approved even if the finance is subsequently approved.

53. This Ruling also does not apply if a Grower enters into an 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' 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 terms are of a non-arm's length nature;
- repayments of the principal and 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) 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 or become involved, in the provision of finance for the Project.

Ruling

Application of this Ruling

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

- on or before 30 June 2003 where the Grower has executed a Lease Agreement (where applicable) and a Management Agreement on or before that date (2003 Growers and 2003 Pre-paid Growers);
- on or after 1 July 2003 where:
 - the Grower has executed a Lease (where applicable) and a Management Agreement on or after that date; and
 - the Manager has accepted the application with the intention of completing Establishment Services by 30 June 2004 (2004 Growers).

55. The Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the project is accepted and the Project has commenced.

The Simplified Tax System ('STS')***Division 328***

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

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

56A. Changes to the STS rules apply from 1 July 2005. From that date, 'STS taxpayers' may use the accruals accounting method. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

Qualification

57. 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.

Assessable Income***Section 6-5 and section 328-105***

58. 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.

59. A Grower who is not an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the accruals method of accounting for the 2006 and later income years, recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

60. A Grower who is an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the cash method of

accounting for the 2006 and later income years, recognises ordinary income from carrying on the business of afforestation at the time that income is received.

Deductions for Management fees and Lease fees

Section 8-1 and section 328-105

61. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Tables.

62. However, if for any reason, an amount shown or referred to in the Tables below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years, then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred, will be deductible in the year in which it is actually paid.

63. The deductions available for each class of Grower will be available for each year end in accordance with the following Table.

	Establishment Fee	First Period Fee	Year 2
2003 Grower	30/6/2003	30/6/2004	30/6/2005
Pre-paid 2003 Grower	30/6/2003	30/6/2005	30/6/2006
2004 Grower	30/6/2004	30/6/2005	30/6/2006

Option 1 - Annual Lease and Management Fees

64. Where the Grower elects to pay fees annually, or is deemed to have elected to pay fees annually, the deductions set out in the Table below will be allowable on a per Sandalwood Lot basis:

Fee Type	ITAA 1997 Section	Establishment Period	Year 1	Year 2
Management Fees	8-1	\$214,500 See Notes (i) & (ii)	\$66,000 See Notes (i) & (iii)	\$28,050 (indexed) See Notes (i) & (iii)
Rent, (where and is leased)	8-1	Nil	\$6,600 See Notes (i), (iii) & paragraph 66	\$6,600 (indexed) See Notes (i), (iii) & paragraph 66

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example at paragraph 135;
- (ii) The Establishment Fee is payable on application in respect of services to be provided in the Establishment Period. For 2003 Growers and 2004 Growers the Establishment Fee is for services provided within the expenditure year and the prepayment provisions do not apply. However, for Pre-paid 2003 Growers the Establishment Fee is for services that will not be provided within the expenditure year and is subject to the prepayment provisions. Under these provisions the Establishment Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 106 to 110 in the Explanations). Therefore, for all Growers, the Establishment Fee is deductible in the year in which it is incurred (where the Grower is **not an 'STS taxpayer'**) or the year in which it is paid (where the Grower is an **'STS taxpayer'**); and
- (iii) The annual Rent and the annual Management Fees for Year 1 and Year 2 are for services to be provided within the expenditure year and are deductible in the year in which they are incurred (where the Grower is not an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the accruals accounting method for the 2006 and later income years) or the year in which they are paid (where the Grower is an 'STS taxpayer for the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years.)

Option 2 - Prepayment of Lease and Management Fees

65. Where a Grower elects to prepay all annual lease and management fees due for the life of the Project after the Establishment Period, the following amounts are deductible per Sandalwood Lot:

Fee Type	ITAA 1997 Section	Establishment Period	Year 1	Year 2
Management Fees	8-1	\$214,500 See Notes (i) & (ii)		
Prepaid Rent and Management Fees (land leased)	8-1 & 82KZMF of the ITAA 1936		\$33,000 See Note (iv)	\$33,000 See Note (iv)
Prepaid Management Fees (land purchased)	8-1 & 82KZMF of the ITAA 1936		\$24,750 See Note (iv) and paragraph 66	\$24,750 See Note (iv) and paragraph 66

Notes:

- (iv) The prepaid lease and management fees described in paragraph 39 are **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 paragraphs 100 to 105 below). This section operates to apportion expenditure over the eligible service period or ten years, whichever is the lesser.

Purchase of land

66. Growers who purchase land will not be entitled to claim the deductions shown for Rent in the tables above. The land is a 'CGT asset' (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire that asset is an outgoing of capital and is not allowable as a deduction. The amount paid for the land will represent the first element of the cost base of the land (subsection 110-25(2)). Any subsequent disposal of the land by a Grower will be a CGT event and may give rise to a capital gain or loss under Part 3-1.

Interest

67. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However, all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 98 to 105 (below) as those rules may be applicable if

interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 - Commissioner's discretion

68. For a Grower who is an individual and who enters the Project during the years ended 30 June 2003 or 30 June 2004, 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 in the following table 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.

2003 Grower	30 June 2003 to 30 June 2015
Pre-paid 2003 Grower	30 June 2003 to 30 June 2016
2004 Grower	30 June 2004 to 30 June 2016

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

- the 'exception' in subsection 35-10(4) applies; or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

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

71. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Sections 82KZME - 82KZMF, 82KL and Part IVA

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

- expenditure by the Grower does not fall within the scope of sections 82KZME - 82KZMF except where the Grower elects to prepay fees under Option 2 described above;
- 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**Corporations Act 2001**

73. For this Ruling to apply, an offer for an interest in the project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in Section 761G of the *Corporations Act 2001*; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the *Corporations Act 2001*.

74. Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

75. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); and
- the 'professional investor test' (paragraph 761G(7)(d)).

76. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000.

77. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘individual wealth test’ where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

78. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘professional investor test’ where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

79. Alternatively, under section 1012E, a Grower may participate in the project by accepting a ‘personal offer’ for an interest in the project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

80. An offer will be a ‘personal offer’ where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Is the Grower carrying on a business?

81. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s afforestation activities as a participant in TFS Gold Card Sandalwood Project 2003 must amount to the carrying on of a business of primary production.

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

83. For schemes such as that of TFS Gold Card Sandalwood Project 2003, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* (1984) 16 ATR 55; 84 ATC 4929.

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

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

85. In this Project each Grower enters into a Management Agreement. Each Grower will either purchase at least 5 hectares of land or enter into a Lease Agreement.

86. Under the Lease Agreement, each individual Grower will have rights over a specific and identifiable area of at least 5 hectares of land. The Agreement provides the Grower with an ongoing interest in the specific Trees on the Plantation for the term of the Project. Under the lease, the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Agreement allows the Project Manager to come onto the land to carry out its obligations.

87. Under the Management Agreement, the Manager is engaged by the Grower to establish and maintain the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and

credentials to provide the management services to establish and maintain the Plantation on the Grower behalf.

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

89. 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.

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

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

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

93. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the TFS Gold Card Sandalwood Project 2003 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

94. 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.

95. 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 lease and management fees***Section 8-1***

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

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

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

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

98. 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.

99. 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

100. 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 104 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)).

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

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

102. 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 not associated with the Project. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions 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.

103. 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.

104. 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.

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

105. 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

106. 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).

107. 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.

108. 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.

109. 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.

110. 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 Sandalwood Lot and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

Establishment Fee

111. Under the Management Agreement, 2003 Growers and 2004 Growers incur an Establishment Fee for Establishment Services to be provided within the expenditure year. The prepayment provisions, therefore, do not apply to the Establishment Fee paid by 2003 Growers and 2004 Growers. For Pre-paid-2003 Growers, however, the Establishment Services will not be wholly provided within the expenditure year and, therefore, the prepayment provisions will apply. For Pre-paid-2003 Growers the Establishment Fee is expenditure for 'seasonally dependent agronomic activities' and meets all other

requirements of section 82KZMG. The timing of the deduction allowable for the Establishment Fee therefore depends upon whether the Pre-paid 2003 Grower is an STS taxpayer or is not an STS taxpayer.

112. A Pre-paid 2003 Grower who is an 'STS taxpayer' can claim an immediate deduction for the Establishment Fee in the income year in which the fee is paid. A Pre-paid 2003 Grower who is not an 'STS taxpayer' can claim an immediate deduction for the Establishment Fee in the income year in which the fee is incurred.

Option 1 - Annual Lease and Management Fees

113. Under the Management Agreement, annual management fees are incurred on each 1 July and 1 January during the term of the Project for management services to be provided during that expenditure year.

114. Under the Lease Agreement, Growers incur fees on each 1 July and 1 January during the term of the Project for the lease of the land during that expenditure year.

115. On this basis, provided a Grower incurs this expenditure on the dates set out in the Management Agreement and the Lease Agreement (see paragraphs 32 to 38 of this Ruling), then the basic precondition in subsection 82KZME(2) of the ITAA 1936 is not satisfied and, in these circumstances, section 82KZMF of the ITAA 1936 will have no application. Deductions for these fees will be deductible in the year in which they are paid (where the Grower is an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years) or the year in which they are incurred (where the Grower is not an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the accruals accounting method for the 2006 and later income years).

Option 2 – Prepayment of Lease and Management Fees

116. Under Option 2, Growers may elect to prepay lease and management fees for the remaining life of the Project after the end of the Establishment Period. For these Growers, this expenditure meets the requirements of section 82KZME and the amount and timing of deductions will be determined using the formula in section 82KZMF. Because the expenditure is not incurred for 'seasonally dependent agronomic activities' it is outside the scope of section 82KZMG. In applying the formula in section 82KZMF to expenditure incurred by Growers who prepay fees under Option 2 the 'eligible service period' will be 10 years.

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

117. Although not required under the Lease and Management Agreements for Option 1 above, a Grower participating in the Project may choose to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Growers who borrow funds in order to participate in the Project may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 115 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

118. 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

119. 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.

120. 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.

121. 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.

122. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of

less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

123. 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).

124. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation in the Project of one interest during the year ended 30 June 2003 or 2004 is unlikely to have their activity pass one of the tests until the year ended 30 June 2016 (for 2003 Growers) or the year ended 30 June 2017 (for 2003 Pre-paid Growers and 2004 Growers).

125. 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.

126. 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.

127. Information provided with this Product Ruling indicates that a Grower who acquires the minimum allocation in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2016 (2003 Growers) or 30 June 2017 (2003 Pre-paid Growers and 2004 Growers).

128. The Commissioner will decide for such a 2003 Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year until the year ended 30 June 2015. Similarly, the Commissioner will decide for such a 2003 Pre-paid Grower or a 2004 Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year until the year ended 30 June 2016.

129. This Product Ruling is issued on a prospective basis (i.e. before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 68) in the manner described in the Arrangement (see paragraphs 14 to 53). 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) 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.

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

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

Section 82KL

131. 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

132. 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).

133. The TFS Gold Card Sandalwood Project 2003 will be a ‘scheme’ commencing with the issue of the Information Memorandum. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 62 to 65 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.

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

Example**Entitlement to GST input tax credits**

135. 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 \$6,600
(includes GST of \$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:

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

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).

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Commissioner of Taxation

28 May 2003

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;
 PR 1999/95; TR 2000/8; PR 2002/17;
 IT 360

Subject references:

- advance expenses and payments for certain forestry expenditure
- carrying on a business
- commencement of business
- fee expenses
- forestry agreement
- interest expenses
- management fees
- producing assessable income
- product rulings

- public rulings

- seasonally dependent agronomic activity

- taxation administration

- tax avoidance

- tax benefits under tax avoidance schemes

- tax shelters

- tax shelters project

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