



# ***PR 2003/7 - Income tax: Sylvatech Tropical Timbers 2003***

 This cover sheet is provided for information only. It does not form part of *PR 2003/7 - Income tax: Sylvatech Tropical Timbers 2003*

 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: Sylvatech Tropical Timbers 2003

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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.*

*[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**

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

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

## **Terms of Use of this Product Ruling**

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

## **What this Product Ruling is about**

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Sylvatech Tropical Timbers 2003' or 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 of the (ITAA 1997);
- Section 17-5 of the (ITAA 1997);
- Division 27 of the (ITAA 1997);
- Division 35 of the (ITAA 1997);
- Division 328 of the (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 of the (ITAA 1936);
- Section 82KZME of the (ITAA 1936);
- Section 82KZMF (ITAA 1936);
- Section 82KZMG (ITAA 1936); and
- Part IVA of the (ITAA 1936).

### **Goods and Services Tax**

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

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

### **Changes in the Law**

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

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

### **Note to promoters and advisers**

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

### **Class of persons**

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (for example being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, these persons are referred to as 'Growers'.

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

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling

has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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## Date of effect

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11. This Ruling applies prospectively from 26 March 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Note: The Addendum to this Ruling that issued on 21 January 2004 applies on and from 1 February 2004.

Note 2: The Addendum to this Ruling that issued on 28 June 2006 applies on and from 1 July 2005.

## Withdrawal

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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 arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the

Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

## **Arrangement**

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

- Application for Product Ruling dated 23 January 2003 and additional correspondence dated 19 February 2003, 21 February 2003, 4 March 2003 and 5 March 2003;
- Draft Product Disclosure Statement for Sylvatech Tropical Timbers 2003, dated 12 March 2003;
- **Constitution** for Sylvatech Tropical Timbers 2003, dated 24 February 2003;
- **Draft Licence and Management Agreement** between Sylvatech Securities Ltd [the 'Responsible Entity'] and the Grower, dated 19 February 2003;
- Memorandum of Lease ['Head Lease'] between Tiwi Aboriginal Land Trust [the 'Head Lessor'] and Sylvatech Ltd (formerly Australian Plantation Group), dated 1 January 2000;
- Memorandum of Lease ['Head Lease'] between the Landowner and Sylvatech Ltd [the 'Sub-Lessor'] dated 12 December 2002;
- Draft Sub-Lease between Sylvatech Ltd [the 'Sub-Lessor'] and Sylvatech Securities Ltd [the 'Responsible Entity'], dated 4 March 2003;
- Draft Operations Agreement between Sylvatech Securities Ltd ['Responsible Entity'] and Sylvatech Forestry Pty Ltd [the 'Manager'], dated 10 January 2003;
- Draft Land Preparation Agreement Sylvatech Ltd [the 'Sub-Lessor'] and Sylvatech Forestry Pty Ltd [the 'Manager'], dated 10 January 2003;
- Additional correspondence received 23 December 2003 and 6 January 2004;
- Deed of variation of operations agreement received 6 January 2004;
- Second supplementary constitution received 6 January 2004;

- **Licence and management agreement – extended product ruling growers**, received 6 January 2004;
- Draft Forestry Expert Report prepared for Sylvatech Securities Ltd [the ‘Responsible Entity’], dated 1 January 2003; and
- Compliance Plan for Sylvatech Tropical Timbers 2003, dated 6 March 2003.

**Note: Certain information received from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.**

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

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

### Overview

17. This arrangement is called Sylvatech Tropical Timbers 2003.

Location	Melville Island, one of the Tiwi Islands in the Arafura Sea, 60 km north of Darwin in the Northern Territory, Australia
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Acacia mangium</i> trees for the purpose of producing woodchip or other suitable timber products
Number of hectares offered for cultivation	1,500 hectares offered under this Product Disclosure Statement, with provision for oversubscription.
Size of each interest	0.5 hectares
Number of trees per hectare	Approximately 1,100
The term of the investment	Approximately 8 years
Initial cost	\$2,750 or \$2,475 if 40 or more Treefarm Units are allotted

Initial cost per hectare	\$5,500 or \$4,950 if 40 or more Treefarm Units are allotted
Ongoing costs	Annual Management Fees (which may be deferred) Annual insurance premiums Marketing Fees Harvesting, processing and transporting costs Responsible Entity's Performance Bonus
Other costs	Capital Expenses Future payment obligations which the Responsible Entity reasonably believes will fall due after a distribution is made to Growers Remuneration of expenses of the Responsible Entity for work to be done following the realisation of the Project Property

18. The Project, Sylvatech Tropical Timbers 2003 ASRN 103 855 821, is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for this Project is Sylvatech Securities Limited. The Project land is situated on Melville Island, one of the Tiwi Islands in the Arafura Sea, 60 km north of Darwin in the Northern Territory, Australia.

19. Growers applying under the Product Disclosure Statement will enter into a Licence and Management Agreement with the Responsible Entity. The Landowner has leased the land to Sylvatech Ltd and has consented to the Sub-Lease Agreement to the Responsible Entity. The Responsible Entity will grant a licence to the Grower to enable the Grower to carry on the business of afforestation for the commercial production of *Acacia mangium* trees. Under the Licence and Management Agreement, Growers licence an area of land called a 'Treefarm' for a term of approximately 8 years. Each Treefarm consists of a minimum of one Treefarm Unit which is 0.5 hectares in size.

20. Under the Licence and Management Agreement, Growers appoint the Responsible Entity to manage their Treefarm. The Responsible Entity will enter into an Operations Agreement with Sylvatech Forestry Pty Ltd (the 'Manager') to perform the services required under the Licence and Management Agreement. Under the

Operations Agreement, the Manager will be responsible for the establishment, cultivation, harvesting and sale of the trees.

21. Applications may be accepted by the Responsible Entity on or before 28 February 2004. For the purposes of this Ruling, Growers whose Licence and Management Agreements are executed by 30 June 2003 are referred to as '2003 Growers'. Growers whose Licence and Management Agreements are executed between 1 July 2003 and 31 January 2004 are referred to as '2004 Growers'.

22. Under the Product Disclosure Statement, the Responsible Entity will offer a maximum of 3,000 Treefarm Units, with provision for oversubscription. There is no minimum subscription for the Project. Each participant may subscribe for one or more Treefarm Units at a cost of \$2,750 each. However, Growers who subscribe for 40 or more Treefarm Units, will receive a discount of 10% of the subscription cost. Each Treefarm Unit will be planted with a minimum of 550 trees (1,100 per hectare).

## **Constitution**

23. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to operate the Project. The Responsible Entity will keep a register of Growers (cl.8). The Licence and Management Agreement will be executed on behalf of the Grower following them signing the Application Form and the Power of Attorney in the Product Disclosure Statement. Growers are bound by the Constitution by virtue of their participation in the Project.

## **Compliance plan**

24. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

## **Interest in land**

25. The Licence and Management Agreement commences on the date the Agreement is executed. The Agreement is terminated pursuant to the provisions of the Agreement or on the date of completion of the Project (see paragraph 27 below). Sylvatech Securities Ltd, the Responsible Entity, grants a licence to the Grower under the terms of the Licence and Management Agreement. Should the Head Lease between the Head Lessor and the Sub-Lessor terminate for any reason the Sub-Lease will continue as a Lease

between the Grower and the Head Lessor (cl. 11.2 of the Sub-Lease). Should the Sub-Lease between the Sub-Lessor and the Responsible Entity terminate, then to the greatest extent possible, the Sub-Lessor will honour and assume the obligations, duties and responsibilities of the Sub-Lessee under the Licence and Management Agreements as if it were the licensor under those agreements (cl. 13.5 of the Sub-Lease).

26. Growers are granted an interest in land in the form of a licence to use and occupy their Treefarm for the purpose of planting, growing, maintaining, cultivating and harvesting *Acacia mangium* trees (cl. 3.1(a)). Growers have a legal interest in the Trees grown on the Grower's Treefarm from the commencement of the Project until the date of first Clearfall (Schedule 1 – Dictionary of the Constitution). Growers must pay a licence fee to the Responsible Entity. This fee is included in the Management fees payable under the Licence and Management Agreement (cl.6).

### **Licence and Management Agreement**

27. Each Grower enters into a Licence and Management Agreement with the Responsible Entity. The term of the Project is until the earlier of the date the harvest of the trees is completed, the termination of the Grower's interest under the Agreement or 30 June 2012, or such later date as determined by the Responsible Entity having regard to sound silvicultural practices.

28. Growers contract with the Responsible Entity to establish, maintain and manage the Grower's Treefarm and perform the harvest, processing and sale of the Grower's Product from the Grower's Treefarm. Growers must pay an Establishment fee on application. Growers may elect on application to pay the management fees for each year of the Project annually or use the deferred payment option. Under the deferred payment option, the fee is paid as a percentage out of the Gross Harvest Proceeds.

29. The Responsible Entity will engage the Manager to provide the following Establishment Services:

- supplying and planting seedlings or cuttings of *Acacia mangium*;
- ploughing, ripping and mounding the Treefarm;
- spraying the Treefarm for the control of weeds which may significantly interfere with the establishment of the trees;
- fertilizing the Treefarm in accordance with sound silvicultural practices; and

- planting on the Treefarm sufficient trees in accordance with the number of trees per hectare specified in the Agreement.

30. The Responsible Entity will engage the Manager to perform the following ongoing services:

- maintain, tend and otherwise care for the trees as and when required;
- in the first wet season after planting, replant any significant area(s) of the Treefarm where tree deaths will limit the overall yield of the Treefarm;
- monitor and control weed growth during the first wet season post planting that may limit the growth of the Treefarm;
- monitor the development of the Treefarm and if economically feasible, conduct form pruning operations to reduce the incidence of multi stemmed trees;
- monitor and control, to the extent necessary, any insects or vermin that may be causing significant damage to the trees;
- monitor soil and foliar nutrient status and, to the extent determined necessary, fertilise the trees; and
- maintain in good repair and condition access to the Treefarm.

## **Fees**

31. All Growers must pay an Establishment Fee on application for establishment services. This fee is equal to \$2,750 or \$2,475 per Treefarm Unit if 40 or more Treefarm Units are allotted. For 2003 Growers and 2004 Growers accepted before 1 February 2004, the establishment services will be provided by 28 February 2004. For 2004 Growers accepted between 1 February 2004 and 28 February 2004, the establishment services will be completed by 31 March 2004.

32. Upon application, Growers may elect to pay management fees under the annual payment option or the deferred payment option. Under the annual payment option, Growers are required to pay an amount of \$110 in arrears by 30 June of each year of the Project until the Date of First Clearfall. This fee will be indexed annually commencing in the year ended 30 June 2005. From the date of First Clearfall, the amount of Management fees payable will be calculated by reference to the proportion of Treefarms yet to be harvested. This

amount will be deducted by the Responsible Entity out of the Proceeds Fund once the Net Harvest Proceeds have been determined.

33. If the deferred payment option is elected, up until the Date of First Clearfall, Growers must pay an amount of 13.2% of the Gross Harvest Proceeds which will be deducted from each distribution made from the Proceeds Fund. After the date of First Clearfall, the amount of Management fees payable will be calculated by reference to the proportion of Treefarms yet to be harvested. This amount will be deducted by the Responsible Entity out of the Proceeds Fund once the Net Harvest Proceeds have been determined.

34. A licence fee is payable under the Licence and Management Agreement by all Growers. This fee is included in the annual Management Fee and the deferred management fee (cl. 6, Licence and Management Agreement).

35. All Growers must pay a Marketing fee of 4.4% of the Gross Harvest Proceeds, in respect of marketing services provided under the Licence and Management Agreement. This fee is payable at any time after the Gross Harvest Proceeds have been paid into the Proceeds Fund in accordance with the Constitution and the Net Harvest Proceeds have been determined.

36. All Growers must also pay a Performance Bonus to the Responsible Entity if the distributions paid and payable to the Grower exceed the Performance Bonus Target of \$7,520. The Performance Bonus will be equal to 20% of the distributions paid and payable to the Grower in excess of \$7,520 per Treefarm Unit.

37. All Grower's appoint the Responsible Entity to arrange insurance of the Grower's produce against the destruction of or damage to the Grower's Produce. Up until the date of First Clearfall the Grower will be liable for the annual cost of this insurance. After the Date of First Clearfall, the Responsible Entity will bear the cost of this insurance but will be entitled to have this cost reimbursed from the Proceeds Fund out of Gross Harvest Proceeds.

### **Planting**

38. Under the Licence and Management Agreement, the Responsible Entity is required to prepare the land for planting and supply the necessary seedlings or cuttings of *Acacia mangium*. The Responsible Entity will engage the Manager to provide these services and to plant the seedlings or cuttings on the Treefarms. These will be completed by 28 February 2004 for 2003 Growers and 2004 Growers accepted before 1 February 2004, or 31 March 2004 for 2004 Growers accepted between 1 February 2004 and 28 February 2004. Each Treefarm will be planted with seedlings or cuttings at the rate of approximately 1,100 per hectare. The Manager will, in the first wet

season after planting, replant any significant areas where tree deaths will limit the overall yield of the Plantation to the extent agreed by the Manager and the Responsible Entity (Item 4(b) of the Operations Agreement).

### **Cultivation and Harvesting**

39. The Manager has been contracted by the Responsible Entity to perform all harvesting activities on the Plantation from the Date of First Clearfall (Item 6, Schedule One of the Operations Agreement). Growers appoint the Responsible Entity to sell the Growers' Produce. Responsible Entity will use all reasonable endeavours to arrange for the sale of the Grower's Produce from the clearfalling of the Treefarm (cl 10.1 Licence and Management Agreement).

40. The Responsible Entity will place into the Proceeds Fund Bank Account the Gross Harvest Proceeds from the sale of the trees. The Responsible Entity is entitled to deduct from the Proceeds Fund prior to a Grower receiving a distribution :

- Any insurance premiums, effected by the Responsible Entity under the Licence and Management Agreements, in respect of those Growers' Treefarms remaining at the relevant time and yet to be harvested;
- Management fees after the Date of First Clearfall, payable in respect of Treefarms remaining at the time and yet to be harvested (such fees calculated in accordance with the Licence and Management Agreements);
- Fees payable under the Licence and Management Agreement;
- Capital Expenses – the Responsible Entity may retain and apply such part of the gross income from the Growers' Produce in meeting outgoings which are of a capital nature in relation to the existing assets comprised in an Interest where, in the opinion of the Responsible Entity, these outgoings are most appropriately met in this manner; and
- Upon, the winding up of the Project, the Responsible Entity may retain from the proceeds of realisation of Project Property money –
  - (a) to meet future payment obligations which the Responsible Entity reasonably believes will fall due after a distribution is made to Growers, and

- (b) to pay its own remuneration and expenses for work to be done following the realisation of Project Property.

41. The net amount available for each Grower, after all deductions are made by the Responsible Entity under the Constitution, must be paid to the Growers within 4 months after 30 June of the relevant year. However, if the amount to be distributed to a Grower is less than \$30 per Treefarm Unit, then except for the Final Distribution under the Constitution, the Responsible Entity may in its absolute discretion, not make a distribution. In this case, the net amount will be carried forward for subsequent distribution.

### **Finance**

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

43. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Growers for the Project.

## Ruling

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### Application of this Ruling

44. This Ruling applies only to Growers who are accepted to participate in the Project on or before 28 February 2004 and who have executed a Licence and Management Agreement. 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*

45. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

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

45A. Changes to the STS rules apply from 1 July 2005. From that date, 'STS taxpayers' may use the accruals accounting method. For a Member participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Member 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

46. 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.

**Tax outcomes for Growers who are not ‘STS taxpayers’ or who are ‘STS taxpayers’ using the accruals accounting method for the 2005-06 and later income years**

**Assessable Income**

***Section 6-5***

47. 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.

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

**Deductions for Establishment fee, Management Fees and Insurance**

***Section 8-1***

49. A Grower who is not an ‘STS taxpayer’ or who is an ‘STS taxpayer’ using the accruals accounting method for the 2005-06 and later income years may claim tax deductions for the following revenue expenses:

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>	<b>Year ended 30/6/2006</b>
<b>Establishment Fee</b>	8-1	See Notes (i) & (ii) (below)			
<b>Management Fees (Annual Payment Option Only)</b>	8-1		\$110 - See Notes (i), (iii) & (iv) (below)	\$110 (indexed) - See Notes (i), (iii) & (iv) (below)	\$110 (indexed) - See Notes (i), (iii) & (iv) (below)
<b>Insurance</b>	8-1	As incurred – See Notes (i) & (v) (below)	As incurred – See Notes (i) & (v) (below)	As incurred – See Notes (i) & (v) (below)	As incurred – See Notes (i) & (v) (below)

**2004 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>	<b>Year ended 30/6/2006</b>
<b>Establish - ment Fee</b>	8-1		See Notes (i) & (ii) (below)		
<b>Management Fees (Annual Payment Option only)</b>	8-1		\$110– See Notes (i), (iii) & (iv) (below)	\$110 – See Notes (i), (iii) & (iv) (below)	\$110 – See Notes (i), (iii) & (iv) (below)
<b>Insurance</b>	8-1		As incurred – See Notes (i) & (v) (below)	As incurred – See Notes (i) & (v) (below)	As incurred – See Notes (i) & (v) (below)

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See Example 1 at paragraph 114.
- (ii) The Establishment Fee payable is equal to \$2,750 per Treefarm Unit or \$2,475 per Treefarm Unit if 40 or more Treefarm Units are allotted. For 2003 Growers this constitutes expenditure for 'seasonally dependant agronomic activities' and is deductible in the income year in which it is incurred. For 2004 Growers, this fee is not prepaid and therefore is deductible in full in the year incurred.
- (iii) Where a Grower who is not an 'STS taxpayer' or who is an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years pays the Management fee in the relevant income years shown in the Licence and Management Agreement, those fees are deductible in full in the year they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (for example the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 76 to 83). In such cases, the tax deduction for the prepaid fee

must be determined using the formula shown in paragraph 82 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.

- (iv) This amount is only deductible by Growers who elect on application to pay management fees under the annual payment option. Growers who elect to pay management fees under the deferred payment option are not entitled to this deduction.
- (v) The cost of insuring the Grower's Produce is deductible when incurred. However, Growers should read the discussion of the prepayment rules in paragraph 76 to 83 (below) as those rules may be applicable if the insurance cost is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the amount is required to be prepaid or is at the Grower's choice.

### **Tax outcomes for Growers who are 'STS taxpayers' or 'STS taxpayers' using the cash accounting method for the 2005-06 and later income years**

#### **Assessable Income**

##### ***Section 6-5***

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

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

#### **Deductions for Establishment Fees, Management Fees and Insurance**

##### ***Section 8-1 and section 328-105***

52. A Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years may claim tax deductions for the following revenue expenses:

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>	<b>Year ended 30/6/2006</b>
<b>Establishment fee</b>	8-1 & 328-105	See Notes (vi), (vii) & (viii) (below)			
<b>Management Fee (Annual Payment Option Only)</b>	8-1 & 328-105		\$110 - See Notes (vi), (vii), (ix) & (x) (below)	\$110 (indexed)- See Notes (vi), (vii), (ix) & (x) (below)	\$110 (indexed)- See Notes (vi), (vii), (ix) & (x) (below)
<b>Insurance</b>	8-1 & 328-105	When Paid - See Notes (vi) & (xi) (below)	When Paid - See Notes (vi) & (xi) (below)	When Paid - See Notes (vi) & (xi) (below)	When Paid - See Notes (vi) & (xi) (below)

**2004 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year Ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>	<b>Year ended 30/6/2006</b>
<b>Establishment fee</b>	8-1 & 328-105		See Notes (vi), (vii) & (viii) (below)		
<b>Management Fee</b>	8-1 & 328-105		\$110 - See Notes (vi), (vii), (ix) & (x) (below)	\$110 (indexed)- See Notes (vi), (vii), (ix) & (x) (below)	\$110 (indexed)- See Notes (vi), (vii), (ix) & (x) (below)
<b>Insurance</b>	8-1 & 328-105		When Paid - See Notes (vi) & (xi) (below)	When Paid - See Notes (vi) & (xi) (below)	When Paid - See Notes (vi) & (xi) (below)

**Notes:**

- (vi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See Example 1 at paragraph 114.
- (vii) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.
- (viii) The Establishment Fee payable is equal to \$2,750 per Treefarm Unit or \$2,475 per Treefarm Unit if 40 or more Treefarm Units are allotted. For 2003 Growers this constitutes expenditure for 'seasonally dependant agronomic activities' and is deductible in the income year in which it is incurred. For 2004 Growers, this fee is not prepaid and therefore is deductible in full in the year incurred.
- (ix) Where a Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years, pays the management fee in the relevant income years shown in the Licence and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (for example the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 76 to 83) . In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 82, 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.
- (x) This amount is only deductible by Growers who elect on application to pay management fees under the annual payment option. Growers who elect to pay management fees under the deferred payment option are not entitled to this deduction.

- (xi) The cost of insuring the Grower's Produce is deductible when paid. However, Growers should read the discussion of the prepayment rules in paragraph 76 to 83 (below) as those rules may be applicable if the insurance cost is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the amount is required to be prepaid or is at the Grower's choice.

### **Tax outcomes that apply to all Growers**

#### ***Interest***

53. 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 76 to 83 (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***

54. For a Grower who is an individual and who enters the Project during the year 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 ending 30 June 2003 to 30 June 2011 for 2003 Growers and 30 June 2004 to 30 June 2011 for 2004 Growers that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- the 'exception' in subsection 35-10(4) applies (see paragraph 101 in the Explanations part of this ruling, below);
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or

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

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

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

### ***Sections 82KZME – 82KZMF, 82KL and Part IVA***

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

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 76 to 83);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## **Explanations**

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

59. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's afforestation activities as a participant in Sylvatech Tropical Timbers 2003 must amount to the carrying on of a business of primary production.

60. For schemes such as Sylvatech Tropical Timbers 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* 84 ATC 4929, (1984) 16 ATR 932.

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

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

62. In this Project, each Grower enters into a Licence and Management Agreement.

63. Under the licence, each individual Grower will have rights over a specific and identifiable area of land (Treefarm). The Licence and Management Agreement provides the Grower with an ongoing interest in the specific trees on the Treefarm for the term of the Project. Under the licence the Grower must use the Treefarm in question for the purpose of carrying out afforestation activities and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Licence and Management Agreement.

64. Under the Licence and Management Agreement the Responsible Entity is engaged by the Grower to maintain the trees on the Grower's Treefarm during the term of the Project, according to the principles of sound afforestation practice which includes irrigation, fertilisation and weed control. The Responsible Entity will subcontract the management services to the Manager under the Operations Agreement. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Treefarm on the Grower's behalf.

65. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the trees grown on the Grower's Treefarm.

66. 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.

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

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

69. The Responsible Entity's services are consistent with general afforestation practices. While the size of a Treefarm is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

71. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in Sylvatech Tropical Timbers 2003 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

72. 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.

73. 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 Establishment Fees and Management Fees*****Section 8-1***

74. Consideration of whether the initial establishment fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

75. The establishment fee and management 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 regular sale of wood produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the establishment fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

**Prepayment provisions*****Sections 82KZL to 82KZMG***

76. 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 (for example 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.

77. For this Project only section 82KZL (an interpretative 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***

78. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the ‘expenditure year’ (subsection 82KZME(1)).

79. 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.

80. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

81. 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.

82. 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.

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

83. 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***

84. 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).

85. 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.

86. 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 is more than one participant in the agreement in the same capacity as the taxpayer; or
  - (b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

87. 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.

88. 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*

89. Under the Licence and Management Agreement, a 2003 Grower incurs an Establishment fee in Year 1 consisting of expenditure of \$2,750 or \$2,475 if 40 or more Treefarm Units are allotted, in respect of 'seasonally dependent agronomic activities'.

90. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2003 for 2003 Growers for the expenditure incurred under the Licence and

Management Agreement for 'seasonally dependent agronomic activities'.

91. For 2003 Growers and 2004 Growers who elect to pay Management Fees under the annual payment option, the Licence and Management Agreement also requires Growers to incur a Management Fee of \$110 per year during Years 2 to 9, for the performance of management services during the term of the Project. Under the Licence and Management Agreement, 2003 Growers and 2004 Growers incur Licence Fees which are incorporated into the Management Fee to licence land during the term of the Project.

92. The Management Fees incurred under the Licence and Management Agreement in Years 2 to 9 are not prepaid. The Establishment Fee incurred under the Licence and Management Agreement by 2004 Growers is also not prepaid. The Management Fees are charged for providing management services and for the licence of the land to a Grower until 30 June of the year in which the fees are incurred. The Establishment Fee is for establishment services to be provided in the first year of the Project.

93. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the Management Fees in Years 2 to 9, or to the Establishment Fee incurred by 2004 Growers.

94. A Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' or who is an 'STS taxpayer' using the accruals accounting method for the 2005-06 year and later can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

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

95. Although not required under the Licence and Management Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 93 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

96. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

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

### **Deferral of losses from non-commercial business activities**

#### ***Division 35***

98. 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.

99. 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.

100. 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.

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

102. In broad terms, the tests require:

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

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

103. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one Treefarm in the Project is unlikely to have their activity pass one of the tests.

104. 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.

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

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

106. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Treefarm in the Project is expected to be carrying on a business activity that will produce a taxation profit, for the income year ended 30 June 2012.

107. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2011.

108. This Product Ruling is issued on a prospective basis (for example 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 106), in the manner described in the Arrangement (see paragraphs 14 to 43). If so, this

Ruling, and specifically the decision in relation to paragraph 35-55(1), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1) will apply in such changed circumstances.

109. 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 provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

### ***Section 82KL***

110. 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***

111. 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).

112. Sylvatech Tropical Timbers 2003 will be a 'scheme' commencing with the issue of the Product Disclosure Statement. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 49 and 52 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.

113. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their wood produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling.

There 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

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

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

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

\*Taxable supply

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

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

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

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

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

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

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

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

## **Detailed contents list**

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

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## Commissioner of Taxation

26 March 2003

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*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

TR 2000/8; PR 1999/95; TR 92/1;  
TR 92/20; TR 97/11; TR 97/16; TD  
93/34; TR 98/22; IT 360

*Subject references:*

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

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