



PR 2004/32 - Income tax: Macquarie Forestry Investment 2004

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 This document has changed over time. This is a consolidated version of the ruling which was published on *24 March 2004*



Product Ruling

Income tax: Macquarie Forestry Investment 2004

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

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Macquarie Forestry Investment 2004' 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 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Section 25-25 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Part 3-1 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Section 82KZL (ITAA 1936);
 - Sections 82KZME - 82KZMF (ITAA 1936);
 - Section 82KZMG (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws 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 specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e. being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

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

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 24 March 2004, 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 commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. 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 persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 15 December 2003 as constituted by documents provided on 15 December 2003, and dated 17 December 2003, 6 February 2004, 10 February 2004, 18 February 2004 and 27 February 2004 and additional correspondence dated 19 January 2004, 6 February 2004 and 20 February 2004;
- Draft Product Disclosure Statement for the Macquarie Eucalypt Project 2004 and Macquarie Timber Land Trust 2004 received under covering letter dated 27 February 2004;
- Constitution of the Macquarie Eucalypt Project dated 18 December 2003;
- Draft Macquarie Eucalypt Project 2004 Amending Deed received under covering letter dated 6 February 2004;
- Draft Compliance Plan of the Macquarie Eucalypt Project 2004 dated 15 December 2003;
- **Draft Ground Lease 2004 between Macquarie Bank Limited ('Landlord') ('MBL') and the Grower dated 15 December 2003;**
- **Draft Forest Property Agreement between MBL ('Grantor') and the Grower of 15 December 2003;**
- **Draft Agreement for Ground Lease 2004 and Forest Property Agreement 2004 between the Landlord and the Grower** received under covering letter dated 6 February 2004;
- Draft MFSPL Management Agreement 2004 between Macquarie Forestry Services Pty Limited ('MFSPL') and Macquarie Alternative Assets Management Limited ('MAAML') dated 15 December 2003;
- Draft Midway Management Agreement 2004 between Midway Pty Limited ('Midway'), MFSPL, MAAML and MBL dated 15 December 2003;
- **Draft Off – Take Agreement 2004 between Midway, MAAML and the Grower dated 15 December 2003;**
- Draft Pricing and Payment Schedule 2004 between Midway and MAAML ('Manager') dated 15 December 2003;

- Draft Greening Australia Services Deed 2004 between Greening Australia Limited ('Service Provider'), MFSPL and MAAML dated 15 December 2003;
- Custody Agreement between MAAML ('Manager'), Bond Street Custodians Limited ('Custodian') dated 26 March 2003;
- Draft Amending Agreement to the Custody Agreement dated 26 March 2003 dated 15 December 2003;
- Constitution of the Macquarie Timber Land Trust 2004 dated 18 December 2003;
- Draft Compliance Plan of the Macquarie Timber Land Trust 2004 dated 15 December 2003;
- Draft Option Deed between the Grantor and MBL and/or nominee ('Grantee') dated 15 December 2003;
- Draft Agreement for Sale between MBL ('Owner') and MAAML ('Transferee') dated 15 December 2003;
- Draft Contract of Sale between MBL ('Vendor') and MAAML and/or nominee ('Purchaser') dated 15 December 2003; and
- Draft Loan & Security Agreement and Notice of Mortgage between MBL and the Borrower received with the application for a Product Ruling dated 15 December 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. The effect of these agreements is summarised as follows.

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

Overview

17. The salient features of the Macquarie Forestry Investment 2004 are as follows:

Location	The land will be located within an economic haulage distance of a log processing Millgate - eg the Offtaker's processing facilities at the port of Geelong, Victoria or processing facilities located in the Morwell region of eastern Victoria.
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Eucalyptus Globulus</i> (Tasmanian Blue Gum)) trees for the purpose of harvesting and selling timber.
Number of hectares offered for cultivation	Up to 4,000
Size of each interest	0.33 of a hectare
Minimum allocation	1 interest in the Tree Project and/or 1 unit in the land trust.
Number of trees per interest	Average of 333
Term of the Project	Approximately 11.5 years
Initial cost	\$2,563 Plantation Establishment Fee for an Interest in the Timber Product and/or \$500 application fee for a Unit in the Land Product.
Initial cost per hectare	\$7,689 (Tree Product only)
Ongoing costs	Deferred Management Fee of 5% of Net Harvest Proceeds or any Tree Insurance Proceeds. Rent of 10% of Net Harvest Proceeds or any Tree Insurance Proceeds.

18. The arrangement is called the Macquarie Forestry Investment 2004 ('the Investment'). The Investment consists of the Macquarie Eucalypt Project 2004 ('the Timber Product') and the Macquarie Timber Land Trust 2004 ('the Land Product'). This Ruling only applies to participants in the Timber Product who have taken out insurance in respect of the trees, at or before the time of planting, against damage or destruction in terms of clause 4.1(b) of Schedule 1 of the Constitution of the Macquarie Eucalypt Project 2004. The Ruling does not address the tax consequences of disposing of Units in the Land Product.

19. Under the Product Disclosure Statement, Macquarie Alternative Assets Management Limited (MAAML) is offering

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Interests in the Timber Product at an application price of \$2,563 per Interest and Units in the Land Product at an application price of \$500 per Unit. The Timber Product and the Land Product are not stapled securities and investors may apply for Interests in the Timber Product ('Growers'), Units in the Land Product ('Land Investors') or both Interests in the Timber Product and Units in the Land Product ('Growers'). The minimum application for each Grower is one Interest in the Tree Product and/or one Unit in the Land Product.

20. The offer closes on 12 December 2004, or earlier at MAAML's discretion. If MAAML in its discretion closes the offer early, it may in its discretion, re-open the offer prior to the final close on 12 December 2004.

21. MAAML will act as the Responsible Entity for both of the Products. An interest in the Timber Product comprises a Plantation Lot of one third of a hectare which will be leased by the Grower from the Responsible Entity to carry on the business of growing eucalypt trees. At the termination of the Project, Midway Pty Limited (Midway) will harvest and purchase the Grower's trees. The harvest is currently expected to occur on or before 31 December 2015.

22. The Harvest Period is defined in the Product Disclosure Statement as running from 1 January 2015 to 31 December 2015. The Growers will receive their Net Harvest Proceeds in instalments, which are expected to be on a monthly basis, throughout the Harvest Period. The Harvest Period will not be longer than 12 months.

23. Midway is to select land for the Project in the catchment area of Geelong in Victoria and the Morwell region of Eastern Victoria, which satisfies a detailed protocol for land selection which has been developed by MBL. The protocol employs a site classification system based on climate and soils that correlates with plantation productivity predictions.

24. MBL will purchase suitable land recommended by Midway. Once it has acquired the land, MBL will, pursuant to the Agreement for Ground Lease and Forestry Property Agreement, enter the Ground Lease and Forest Property Agreement with each Grower for the term of the Project. The Land Trust will then enter into an Agreement to acquire the land from MBL and the land will be transferred to the Land Trust subject to the Ground Lease and the Forest Property Agreement.

25. The land will be acquired and the Lease and Forest Property Agreement granted to an Investor before the first of:

- (a) the expiry of 9 months after the grant of the Interest to the Investor; and
- (b) the date that is three months before the end of the Initial Term for that Interest.

MAAML, as the Land Trust Responsible Entity will hold the land on behalf of the Land Investors. The Land Trust will derive rental income and proceeds from the sale of the Project land at the termination of the Project. The Growers may receive distributions from the Trust.

Constitution of the Macquarie Eucalypt Project 2004

26. The Constitution establishes the Scheme known as the Macquarie Eucalypt Project 2004 and operates as a deed declared to be for the benefit of and binding on the Members. It sets out the terms and conditions under which MAAML agrees to act as the Manager of the Scheme.

27. Under the Constitution the Manager must hold any Scheme Property on trust for Members or cause it to be held by a Custodian.

28. An applicant for Interests must complete the Application Form attached to the Product Disclosure Document issued by the Manager in connection with the Scheme. Payment in a form acceptable to the Manager, of the Plantation Establishment Fee must:

- (a) accompany the Member's Application; or
- (b) be received by or made available to the Manager or the Custodian within such period before or after the Manager receives the Member's Application as the Manager determines from time to time.

29. Money paid with or in relation to a Member's Application for an Interest is to be held by the Manager in a trust account in accordance with the Corporations Act pending the issue of the Interest. Once the Interest is issued the Manager may retain the Plantation Establishment Fee on its own account.

30. If the Manager rejects a Member's application, the Application Fee is to be refunded to the Member at the time that they are notified of the rejection.

31. The Constitution states the various fees and expenses to which the Manager is entitled during the term of the Project. Schedule 1 of the Constitution lists the Manager's obligations in respect of each Member during both the Initial Term and the period following the Initial Term, as follows:

- (i) The Manager shall purchase seedling trees selected from stock which it believes will produce yields in accordance with the assumptions outlined in the Product Disclosure Statement;
- (ii) The Manager will plant approximately 333 trees per Plantation Lot during the Initial Term for each Interest

and will do all things necessary to ensure that the seedling trees are tended according to principles of good farming practice and sound agricultural methods;

- (iii) The Manager will:
- (a) not use the Land except for the purpose of the Member's Business and purposes ancillary to the Member's Business;
 - (b) control vermin and weeds to maintain satisfactory tree growth and to fulfil regulatory requirements with respect to noxious weeds and vermin;
 - (c) manage tree nutrition (monitoring and if reasonably required, treatment) to achieve or maintain satisfactory tree growth;
 - (d) maintain firebreaks, access tracks and water supply points for fire suppression purposes and comply with all reasonable directions and all statutory requirements in relation to the prevention and control of fire;
 - (e) liaise with the relevant government authorities with respect to fire suppression and prevention;
 - (f) maintain a plantation inventory for the establishment of permanent growth plots and measurement at regular intervals (nominally at 1, 3, 5, 7 and 9 years of age);
 - (g) monitor plantation health throughout the year;
 - (h) liaise with the community and government in terms of dealings with neighbours, local government and regulatory authorities etc with respect to the ongoing management of the Land;
 - (i) manage any grazing by livestock on the Land and the Other Land (being the other land owned by the Lessor which is not subject to the Leases but which the Manager, MFSPL and Midway require access to and use of in order to perform their obligations), which may commence 2 years following planting;
 - (j) generally keep the Land and the Other Land clean, tidy and in a condition suitable for the conduct of the Member's Business;

- (k) where reasonably required, maintain fencing for the protection of the Land and thereby the Trees of that Member;
- (l) not make any structural alterations or additions to the Land without the consent of Lessor;
- (m) not store nor use, nor permit to be stored or used, on the Land or Other Land any inflammable or dangerous substances, except as may be reasonably required for the ordinary conduct of the permitted use of the Land or the Other Land for the Member's Business and in accordance with regulatory requirements;
- (n) employ such staff and labour as are necessary for the purposes of this schedule including, without limitation, engaging the services of such consulting experts as may be necessary to assist the Manager in providing expert advice and assistance with respect to the growing of the Trees;
- (o) do all other things that are necessary or incidental to the carrying out of the Member's Business to produce a viable business of growing of the Trees for felling or sale when they are sufficiently mature;
- (p) if necessary, arrange for either or both harvesting and sale of the Standing Timber;
- (q) report to the Member on a annual basis as to matters which the Manager determines the Member should be informed of;
- (r) perform its obligations under the Manager's Forestry Documents;
- (s) act as the Member's representative and exercise all of the Member's rights and perform all of the Member's obligations under the Ground Lease and the Forest Property Agreement; and
- (t) collect any other revenue derived from the Land.

32. In particular, the activities to be carried out by the Manager in the Initial Term for which the Plantation Establishment Fee is paid will be land cultivation, vermin control, site preparation (including clearing/earthworks), weed control, planting of seedlings and fertilisation associated with planting.

33. The Initial Term for an Interest, which will be for a period of no more than 12 months, will vary depending on the date on which a Grower's Interest is allotted. The Initial Term will be:

- (a) where the Grower's Interest is issued on or before 30 June 2004 – the period commencing on 30 June 2004 and ending on the first anniversary of that date; and
- (b) where the Grower's Interest is issued on or after 1 July 2004 – the period commencing on the later of:
 - (i) the date the Interest is issued; and
 - (ii) 1 October 2004,and ending on the first anniversary of that date.

34. The Manager will distribute or retain the Net Harvest Proceeds and Other Income of each Member in the following order of priority:

- (a) retain an amount representing any liabilities incurred by the Manager in respect of that Member for the account of the Manager;
- (b) pay any provision for Environmental Debits to the responsible entity for the Timber Land Trust 2004;
- (c) retain the deferred management fee as set out in clause 18.2 of the Constitution for the account of the Manager;
- (d) distribute the rental under the Ground Lease in accordance with clause 7.1 of the schedule to the Timber Land Trust;
- (e) when the Net Harvest Proceeds received by the Manager for the Member and all other Members in the Scheme exceed \$4,500 per Plantation Lot and the average yield of All Standing Timber is greater than 80 GMT per Plantation Lot, retain the Productivity Performance Fee; and
- (f) distribute the balance to the Member.

35. The Net Harvest Proceeds in relation to a Member is defined as the Member's Proportional Interest of the proceeds of sale received by the Manager under the Off-Take Agreements.

36. A Member's Proportional Interest is the proportion which the aggregate Plantation Lots leased to that Member bears to all Plantation Lots leased to all the Members in the Scheme at that time. If a Plantation Lot is affected by an Event (being destruction or damage to any of the Trees) then the Member's Proportional Interest will be determined by the Manager. In this situation the Manager will determine the proportion of that Member's Trees which remain, and the relative market value of those remaining Trees, as they relate to

the Trees which would have been expected on the Plantation Lots leased to that Investor.

37. The Scheme terminates on the earlier of :

- The Termination Date, which is defined in the Constitution as the later of:
 - (a) the Termination of every Member's Lease 2004 and the last payment of the Net Harvest Proceeds and Other Income; and
 - (b) such later date in accordance with any extensions of time as determined by agreement by at least:
 - (i) a resolution or written agreement of Members with at least 75% of all Plantation Lots;
 - (ii) the unit holders who have at least 75 % of the Units in the Macquarie Timber Land Trust 2004;
 - (iii) Midway, to the extent that the Midway Management Agreement 2004 and Off-Take Agreement 2004 have not terminated and are affected by the determination;
- the date on which the Scheme terminates by law; and
- the date 80 years less one day from the date the Scheme commences.

Ground Lease 2004

38. Under the Ground Lease MBL grants a lease to the Grower and the Grower takes a lease of the Land for the Term of the Project, on and subject to the terms of the Ground Lease.

39. MBL also grants to the Grower a licence to access and use the Other Land for all purposes having regard to the Permitted Use of the Land. This right is contractual, non-exclusive and irrevocable for the duration of the Term of the Project.

40. The Term of the Lease is the period commencing on the Commencement Date and expiring on the Termination Date. The Termination Date is the 30 June 2020, however the Landlord may terminate the Lease by notice to the Lessee at any time in its absolute discretion after the latter to occur of:

- (a) 31 December 2015; and

- (b) the final payment of the Net Harvest Proceeds and the final payment of Other Income under the Scheme Constitution.

41. The Rent payable by the Grower to MBL in relation to the Ground Lease is the amount which is 10% of:

- (a) Net Harvest Proceeds; or
- (b) Where an Event occurs, that is, the trees are destroyed or damaged by fire, windstorm or hail, any Tree Insurance Proceeds (that are not applied in replanting the affected parts of the Land), in respect of the Land.

42. Under the Ground Lease, Rent is payable either in arrears when the Net Harvest Proceeds in respect of the Land are distributed under the Scheme Constitution or in arrears when Tree Insurance Proceeds in respect of the Land are paid by the relevant insurer.

43. If a Grower's trees are destroyed or damaged and there is no replanting of the affected parts of the Grower's Plantation Lot, at the Grower's election, the Grower may surrender that part of the Plantation Lot over which those trees were planted, by notice to MBL.

Forest Property Agreement 2004

44. Under this Agreement, in consideration for the Grower paying the Rent under the Ground Lease, MBL vests ownership of the Forest Property in the Grower, acknowledges it has no interest in the Forest Property and grants to the Grower the Carbon Sequestration Rights and any other environmental credits relating to the Land for the Term of the Project. This Agreement terminates at the same time as the Ground Lease terminates.

Agreement for Ground Lease and Forest Property Agreement 2004

45. Under this Agreement, where the Grower holds an Interest on the Commencement Date, MBL agrees to grant, or procure the grant, and the Grower agrees to accept the grant of the Ground Lease and the Forest Property Agreement from and including the Commencement Date.

46. The Grower must deliver to MBL with this Agreement the Form of Ground Lease and the Form of Forest Property Agreement in duplicate executed by the Grower to be held in escrow by MBL.

MFSP Management Agreement 2004

47. Under this Agreement MAAML engages Macquarie Forestry Services Pty Limited (MFSP) to undertake certain of its obligations under the Constitution for the Term of the Project. In particular, MFSP will:

- (i) undertake all the activities listed at paragraph 31 with the exception of the activities listed at paragraph 31(iii)(p), (q), (r), (s) and (t);
- (ii) provide a grid identifying the Plantation Lots of all Growers;
- (iii) provide progress reports to MAAML detailing growth measurements;
- (iv) procure that at least annually an independent forestry advisor reviews the performance of its obligations under this agreement and the growth of the Trees and provides a copy of their report to MAAML;
- (v) enter into an agreement with Greening Australia Limited regarding, amongst other things, environmental services relating to the Scheme and comply with the terms of that Agreement; and
- (vi) where appropriate, advise MAAML on the availability of forestry techniques which may improve the returns to the Growers.

48. MAAML grants to MFSP a licence to access and use (and to allow its subcontractors and agents to access and use) the land and Other Land for all purposes necessary to carry out its obligations under this Agreement.

49. This Agreement commences on the Commencement Date and continues until the Termination Date. In terms of clause 12.4, the Termination Date is the same as that for the Scheme Constitution.

Midway Management Agreement 2004

50. Under this Agreement MFSP sub-contracts some of its obligations under the MFSP Management Agreement to Midway.

51. Midway and MFSP agree that the former will provide the following services:

- (i) undertake all the activities listed at paragraph 31 with the exception of the activities listed at paragraph 31(iii)(p), (q), (r), (s) and (t);
- (ii) purchase seedling Eucalyptus Globulus trees selected from stock which it believes will produce yields in

accordance with the assumptions outlined in the Disclosure Document;

- (iii) in relation to the planting of trees, Midway will plant approximately 333 trees per Plantation Lot during the Initial Term in a manner that results in a survival rate of at least 90% of the trees planted as measured 12 months from the time of planting and will do all things necessary to ensure that the seedling trees are tended according to principles of good farming practice and sound agricultural methods.

In the event that less than 90% of the trees planted survive for 12 months following the date of planting, undertake such additional planting of trees which would result in there being at least 300 trees per Plantation Lot;

- (iv) produce progress reports detailing growth measurements;
- (v) discuss where appropriate with MFSPL and Greening Australia Limited methods of complying with any agreement between MFSPL and Greening Australia Limited and others;
- (vi) prepare and deliver to MFSPL silvicultural working plans detailing the net plantable area and plantation establishment and maintenance strategy for all Land together with a grid identifying the Plantation Lots;
- (vii) undertake such site preparation work as is required to prepare the Plantation Lots for planting including:
 - (a) performing all reasonably required clean-up works; and
 - (b) completing all reasonably required cultivation works;
- (viii) undertake such vermin control work as is reasonably required to protect the Plantation Lots from damage (both before and after planting);
- (ix) undertake all reasonably required weed control work prior to and/or after planting to ensure that the Plantation Lots can be established and can achieve satisfactory growth;
- (x) undertake such fertilisation as is required at or about the time of the planting to promote establishment and satisfactory early growth;

- (xi) in the season following the planting of the seedling trees, undertake nutrition monitoring and fertilisation of, and weed control in, the Plantation Lots if reasonably required to promote or maintain satisfactory growth of the trees; and
- (xii) use its reasonable endeavours to identify the land for the purposes of the Scheme on behalf of MBL, act in accordance with the Land Selection Protocol unless agreed otherwise with MBL, and generate a grid identifying the Plantation Lots.

Off -Take Agreement 2004

52. Under the Off-Take Agreement 2004, Midway agrees to buy and the Grower agrees to sell the Standing Timber at stump for the Selling Price. The Selling Price for All Standing Timber at stump will be calculated and paid in accordance with the Pricing and Payment Schedule. This Schedule forms part of the Off-Take Agreement 2004 and establishes the pricing and payment mechanisms for the Off-Take Agreement 2004. Midway will pay to the Manager the price for All Standing Timber whereupon the Manager will distribute the Selling Price for the Standing Timber as part of the Net Harvest Proceeds.

53. Midway agrees with the Grower that it will, at its own cost and expense:

- (a) harvest the Standing Timber by 31 December 2015 or such later date agreed in writing by Midway and the Manager but no later than 31 December 2020;
- (b) transport the Standing Timber from the Land to Midway's Facility (or to another site agreed between Midway and MAAML) prior to the end of the Harvest Year;
- (c) unless otherwise agreed, produce wood chips from the Standing Timber for sale to its customers; and
- (d) unless otherwise agreed, market the wood chips to its customers for sale.

54. The Grower grants to Midway a licence to access and use the Land for all purposes necessary to carry out its obligations under this Agreement, other Off-Take Agreements and the Midway Management Agreement 2004.

Custody Agreement

55. Under the Custody Agreement (as amended by the Amending Agreement and Notice of Addition to the Custody Agreement) the

Manager appoints Bond Street Custodians Limited as the Custodian and Bond Street Custodians Limited accepts the appointment as the Custodian of the Assets of the Scheme on the terms and conditions of the Agreement.

56. The Custody Agreement lists both the duties and responsibilities of the Custodian in respect of the Assets of the Scheme and the general duties and responsibilities of the Custodian.

Constitution of the Macquarie Timber Land Trust 2004

57. The Constitution establishes the Trust known as the Macquarie Timber Land Trust 2004 and operates as a deed under which the Manager holds assets on trust for the Members. It sets out the terms and conditions under which MAAML agrees to act as the Manager of the Trust.

58. The beneficial interest in the Trust is divided into Units and each Unit confers an equal undivided interest. The Application Price for the Units is \$500 per Unit. Units will be issued to applicants on or before 12 December 2004 provided that on or before that day the Manager has accepted their application and the Manager has received their application money.

59. The Manager may set a minimum application amount and a minimum holding for the Trust and alter those amounts at any time.

Fees

60. The fees payable under the Constitution of the Macquarie Eucalypt Project 2004 and the Ground Lease, on a Plantation Lot basis, are as follows:

- Plantation Establishment Fee of \$2,563 (inclusive of GST) payable on application for the maintenance and management of each Grower's Plantation Lot during the Initial Term;
- Deferred Management Fee for the maintenance and management of each Grower's Plantation Lot for the period commencing after the Initial Term and ending on the Termination Date being an amount equal to either 5% of the Net Harvest Proceeds of each Grower or where an Event has occurred 5% of any Tree Insurance Proceeds;
- Productivity Performance Fee payable if the Net Harvest Proceeds for a Grower exceed \$4,500 per Plantation Lot and the average yield of all Standing Timber is greater than 80 Green Metric Tonne ('GMT')

per Plantation Lot. This Fee is payable for the maintenance and management of each Grower's Plantation Lots for the period commencing after the Initial Term and ending on the Termination Date;

- Rent is payable by the Growers for the lease of their Plantation Lots and for the licence of the Other Land. The Rent is an amount equal to 10% of either Net Harvest Proceeds or where an Event occurs, any Tree Insurance Proceeds; and
- Further, the handling fee for arranging Tree Insurance will be invoiced to the Growers as soon as practicable (but within thirty days). The invoiced amount will be payable by the Growers within thirty days of the invoice date.

61. The Application Fee payable under the Constitution of the Macquarie Timber Land Trust 2004 is \$500 per Unit.

Finance

62. Growers can either fund their involvement in the Project themselves, borrow from an independent lender, or borrow from MBL (a lender associated with the Responsible Entity).

63. Where Growers borrow from MBL, all application monies received (both from Growers directly and from MBL) will be paid into the Macquarie Eucalypt Project 2004 and Macquarie Timber Land Trust 2004 Trust Account, in accordance with clause 6.7 of the Macquarie Eucalypt Project 2004 Constitution. Such application monies will be paid into the respective Trust Accounts on or before the issue date of the Interests or Units.

64. The finance made available by MBL is offered on the following terms contained in the Loan and Security Agreement:

Lender	Macquarie	Macquarie	Macquarie	Macquarie
Term ¹	1 year	3 years	5 years	9 years
Indicative Interest Rate	No interest	9.7%	9.9%	10.9%
Repayment Profile ²	1 year of equal monthly	3 years of equal monthly	5 years of equal monthly	Principal repayments amounting to

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	principal repayments	principal repayments	principal repayments	25% in year 1 followed by principal repayments of 75% in year 9
Interest Payments	N/A	Monthly in arrears	Monthly in arrears	Monthly in arrears
Application Fee	\$100 + 1% of Loan Amount	\$100	\$100	\$100

1. This assumes a Drawdown Date under the Investment Loan after 30 June 2004. If the Drawdown Date is on or before 30 June 2004, the Term of the Investment Loan will be longer, by an amount equal to the number of days from the Drawdown Date to 30 June 2004.
2. Monthly payments of principal and interest will commence on the later of July 2004 and the month following the Drawdown Date.

In each case:

- Maximum amount allowed to be borrowed is \$2,830 for every one Interest in the Timber Product and one Unit in the Land Product;
- The borrowing does not extend to GST. The GST payable in relation to the Plantation Establishment Fee (\$233) must be paid by the Borrower out of his/her own resources;
- The above repayments must be paid irrespective of the amount of any distribution from the Fund or the Trust;
- The interest rate payable on the loan facility will be determined by MBL on the last business day of each month for loans approved the following month, and will be published on the Macquarie Forestry website. This indicative interest rate will be set on an arm's length commercial basis; and
- The Borrower is obliged to obtain and maintain Tree Insurance at all times during the term of any financial accommodation provided by MBL.

65. Growers cannot rely on this Product Ruling if a different finance arrangement is entered into with MBL or if application monies otherwise remain unpaid:

- On 30 June 2004, where the Grower's Interest is issued on or before 30 June 2004; and
- where the Grower's Interest is issued on or after 1 July 2004:
 - (i) on 1 October 2004, where the Grower's Interest is issued from 1 July 2004 to 1 October 2004; or
 - (ii) on the date the Grower's Interest is issued, where the Grower's Interest is issued after 1 October 2004 and on or before 12 December 2004.

Where an application is accepted subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the dates shown in the preceding paragraphs.

66. 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, other than MBL, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

67. This Ruling applies only to Growers who are accepted to participate in the Project on or before 12 December 2004 and who have executed an Agreement for Ground Lease and Forest Property Agreement 2004, a Ground Lease 2004, a Forest Property Agreement 2004 and an Off-Take Agreement 2004 on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

68. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Initial Term for that Grower has commenced.

The Simplified Tax System ('STS')

Division 328

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

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

Qualification

70. 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***

71. 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.

72. The Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

73. The Grower who is an 'STS taxpayer' recognises ordinary income from carrying on the business of afforestation at the time that income is received (paragraph 328-105(1)(a)).

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

74. A Grower who is not an 'STS taxpayer' may, during the Harvest Period, hold wood produce that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the start of an income year a Grower must include the amount of that excess in their assessable income.

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

76. During the Harvest Period, the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

Deductions for Plantation Establishment Fees and Interest***Section 8-1 and section 328-105***

77. A Grower who is accepted into the Project on or before 30 June 2004 may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table(s).

78. 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' then the amount is only deductible to the extent to which it has been paid by, or has been paid for, the Grower. Any amount or part of an amount shown in the Table(s)

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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.

Fee Type	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Plantation Establishment Fee	\$2,563 See Notes (i) & (ii)		
Interest	As incurred (Non-STS taxpayers) Or as paid (STS taxpayers) See Note (iii)	As incurred (Non-STS taxpayers) Or as paid (STS taxpayers) See Note (iii)	As incurred (Non-STS taxpayers) Or as paid (STS taxpayers) See Note (iii)
Borrowing costs for loans with MBL	Must be calculated - see Note (iv)	Must be calculated - see Note (iv)	Must be calculated - see Note (iv)

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 145;
- (ii) The Plantation Establishment Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 113 to 119) and is deductible in the income 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'**);
- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than MBL, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with MBL, should read the discussion of the prepayment rules in paragraphs 105 to 112 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; and
- (iv) The Loan Application fee payable to MBL is a borrowing expense and is deductible under section

25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than MBL is outside the scope of this Ruling.

79. Where Growers enter the Project on or after 1 July 2004 and on or before 12 December 2004, the deductions available for the Years Ended 30 June 2005, 30 June 2006 and 30 June 2007 are those shown above for the Years Ended 30 June 2004, 30 June 2005 and 30 June 2006 respectively.

Units

80. The Units in the Land Trust are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

81. The amount paid for each Unit will represent the first element of the cost base of the Unit (subsection 110-25(2)). Any disposal of the Units by a Grower will be a CGT event and may give rise to a capital gain or loss.

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

Section 35-55 – Commissioner’s discretion

82. For a Grower who is an individual and who enters the Project during the years ended 30 June 2004 and 30 June 2005 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), for the Growers who enter the Project during the year ended 30 June 2004, the Commissioner will decide for the income years ending 30 June 2004 to 30 June 2014 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. For the Growers who enter the Project during the year ended 30 June 2005, the Commissioner will decide for the income years ending 30 June 2005 to 30 June 2014 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.

83. 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 129 in the Explanations part of this ruling; or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

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

85. 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) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Section 82KL and Part IVA

86. For a Grower who participates in the Project and incurs expenditure as required by the Constitution and the Ground Lease the following provisions of the ITAA 1936 have application as indicated:

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

Explanation

Is the Grower carrying on a business?

87. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s afforestation activities as a participant in the Macquarie Forestry Investment 2004 must amount to the carrying on of a business of primary production.

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

89. For schemes such as that of the Macquarie Forestry Investment 2004, 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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

90. 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.

91. In this Project, each Grower enters into a Constitution and Ground Lease.

92. Under the Ground Lease each individual Grower will have rights over a specific and identifiable area of 0.33 of a hectare of land. The Ground Lease provides the Grower with an ongoing interest in the specific trees on the leased area 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 lease allows the Manager to come onto to the land to carry out its obligations under the Constitution.

93. Under the Constitution the Manager is engaged by the Grower to establish and maintain a Plantation Lot on 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

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

94. The Manager is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Plantation Lot.

95. 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.

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

97. The pooling of wood produce from trees grown on the Grower's Plantation Lot 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 Plantation Lot.

98. The Manager's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a Plantation Lot is relatively small, it is of a size and scale to allow it to be commercially viable.

99. The Grower's degree of control over the Manager as evidenced by the Constitution, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Plantation Lot 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.

100. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the Macquarie Forestry Investment 2004 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

101. 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.

102. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to TR 2002/6 and TR 2002/11). 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 the Plantation Establishment Fee

Section 8-1

103. Consideration of whether the Plantation Establishment Fee is 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.

104. The Plantation Establishment Fee associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income (from the harvesting and sale of wood produce) is to be gained from this business. Further, the Fee appears to be reasonable and includes no capital component and no 'non-income producing' purpose in incurring the Fee, is identifiable from the arrangement. It will thus be deductible under the first limb of section 8-1.

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

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

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

Sections 82KZME and 82KZMF

107. 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)).

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

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :

- a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
- b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

109. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than MBL. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the resulting 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.

110. 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.

111. 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.

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

112. 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

113. 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).

114. 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.
115. 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:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.
116. 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.
117. 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

118. Under the Constitution, a Grower incurs a Plantation Establishment Fee of \$2,563 for 'seasonally dependent agronomic activities'.

119. As the requirements of section 82KZMG have been met, a deduction is allowable in the income years ended 30 June 2004 and 30 June 2005 (as applicable) for the expenditure incurred under the Constitution for 'seasonally dependent agronomic activities'.

Interest deductibility***Section 8-1****(i) Growers who use MBL as the finance provider*

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

121. The interest incurred for the years ended 30 June 2004 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing of trees - that will continue to be directly connected with the gaining of 'business income' and 'trust income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

122. In the absence of any application of the prepayment provisions (see paragraphs 105 to 112), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

124. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid.

(ii) Growers who DO NOT use MBL as the finance provider

125. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than MBL is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and

documentation have been provided to, and examined by the Tax Office.

126. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 105 to 112).

Deferral of losses from non-commercial business activities

Division 35

127. 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 satisfied; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

128. 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.

129. 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 satisfied, the discretion is exercised, or the exception applies.

130. 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.

131. 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).

132. 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 Plantation Lot in the Project is unlikely to have their activity satisfy one of the tests. Growers who acquire more than one interest in the Project may however, find that their activity satisfies one of the tests in the income year ended 30 June 2015.

133. Therefore, 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.

134. 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 satisfy one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

135. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Plantation Lot in the Project is expected to be carrying on a business activity that will

produce a taxation profit, for the income years ended 30 June 2015 and 30 June 2016.

136. 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 2014.

137. 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 82), in the manner described in the Arrangement (see paragraphs 14 to 66). 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.

138. 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 expert or scientific evidence provided with the application by the Responsible Entity;
- the binding timber contract(s) with Midway for the sale of the wood produce setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the wood produce is are grown; and
- 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 - recouped expenditure

139. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

140. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

141. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

142. 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).

143. The Macquarie Forestry Investment 2004 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 78 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Entitlement to GST input tax credits

145. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is

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registered for GST and charges her a management fee payable every six months in advance. On 1 December 2003, 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 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (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 2004, 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

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Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 97/16;
 TR 92/20; TD 93/34; TR 98/22;
 TR 2000/8; TR 2002/6; TR 2002/11;
 TR 97/11

Subject references:

- advance deductions and expenses for certain forestry expenditure
- carrying on a business
- commencement of business
- fee expenses
- forestry agreement

- interest expenses
- management fees
- non commercial losses
- 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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