



PR 2005/100 - Income tax: Willmott Forests Project - 2006 Product Disclosure Statement

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 This document has changed over time. This is a consolidated version of the ruling which was published on *6 July 2005*



Product Ruling

Income tax: Willmott Forests Project – 2006 Product Disclosure Statement

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **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 Tax Office **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 Tax Office 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.

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

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 'Willmott Forests Project – 2006 Product Disclosure Statement' 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);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Subdivision 61-J (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Sections 82KZME - 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. 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 are those 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 (that is, 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;
- persons who elect to opt out of the marketing and harvesting arrangement with Willmott Forests Ltd and to organise the harvesting and marketing of 'Trees' produced from their own Woodlots;
- persons who choose to pay by transferring property to the Manager, as set out in clause 4.2 of the Consolidated Constitution of the Willmott Forests Project;
- persons who participate in the Project through offers made other than through the Product Disclosure Statement;
- Willmott Forests Ltd or its associates; and
- persons who are accepted to participate in the Project after 30 June 2006.

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 6 July 2005, 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 2008. 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 28 February 2005 as constituted by documents provided on 10 February 2005 and additional correspondences (including e-mails), dated 9 March 2005, 13 April 2005, 29 April 2005, 4 May 2005, 9 June 2005 and 22 June 2005;
- Draft **Willmott Forests Project - 2006 Product Disclosure Statement** (the 'PDS') issued by Willmott Forests Limited A.B.N. 17 063 263 650 ('WFL', the 'Manager' or the 'Responsible Entity'), received 28 February 2005, amended 13 April 2005 and 22 June 2005;
- Draft Consolidated **Constitution** for the Willmott Forests Project (the 'Constitution'), issued by WFL, dated 2 September 1999 and amended January 2005;
- Proforma **Lease Agreement** (the 'Lease Agreement') to be entered into by each Grower (the 'Lessee') and WFL (the 'Lessor'), received 28 February 2005;
- Proforma **Pre-Lease Agreement**, which may be entered into by each Grower and Willmott Forests Limited ('WFL'), received 28 February 2005;
- Proforma **Forestry Management Agreement**, to be entered into by each Grower and Willmott Forests Limited (the 'Responsible Entity'), received 28 February 2005 and amended 12 April 2005;
- Draft Forestry Right Agreement, to be entered into by each Grantor, who is or is entitled to be the registered proprietor of the 'Land' and, Willmott Forests Investment Management Pty Ltd (the 'Grantee'), a wholly owned subsidiary of the Manager, which acts as an agent on all the Growers behalf, received 28 February 2005;
- Draft **Terms Agreement**, which may be entered into by WFL and each Grower ('the Borrower'), received 28 February 2005 and amended 9 June 2005; and
- The Compliance Plan for WFL, dated 27 September 2001 and amended 28 May 2004.

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

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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.

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 Willmott Forests Project – 2006 Product Disclosure Statement are as follows:

Location	Bombala region of south east NSW and Murray Valley region of NSW.
Type of business to be carried on by each participant	Long term commercial plantations for the purpose of harvesting <i>pinus radiata</i> .
Number of hectares offered for cultivation	Approximately 3,000 hectares with an option to secure further interests if required.
Size of each interest	0.5 hectares (one 'Woodlot')
Number of 'Trees' per hectare	Minimum of 1,000 seedlings
Term of the Project	25 years
Initial cost	\$3,850 per Woodlot
Initial cost per hectare	\$7,700
Ongoing costs	Maintenance and lease rental costs will be 7% and 2% respectively of the 'Gross Timber Proceeds' from the 'Thinnings' and the 'Clear Fell' of the 'Trees' on each Woodlot, or from insurance proceeds in respect of the damage, or destruction of, the Grower's 'Trees' on a Woodlot.
Other costs	Harvesting Fee, of 1% of 'Gross Timber Proceeds' from the 'Thinnings' and the 'Clear Fell' of the 'Trees' on each Woodlot; Compulsory insurance premium from year 3 to the year proceeding the 'Clear Fell' of the Trees'; Interest payments, under a Terms Agreement; and Any other amounts agreed upon in writing between WFL and Growers.

18. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Willmott Forests Limited has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project.
19. The objective of the Project is to establish and manage long term commercial plantations of softwood for the purpose of harvesting and sale.
20. An offer to participate in the Project will be made through the PDS. The offer under the PDS is for approximately 3,000 hectares in the Project and will invite participants to apply for one or more Woodlots each of 0.5 hectare in size.
21. To participate in the Project as Growers, participants must complete the 2006 Application Form ('the Application Form') in the PDS, enter into a Lease Agreement and a Forestry Management Agreement with WFL and, make a payment and/or payment arrangement under a Terms Agreement for the Woodlots subscribed.
22. Where there is no 'Project Land' available for a Grower on or before 30 June 2006, the Manager may still accept the Grower's application and, the Manager and the Grower will enter into a Pre-Lease Agreement in which Willmott undertakes to take all reasonable steps to grant a 'Lease' in respect of the Grower's Woodlots within nine months of the date of acceptance of the Grower's application.
23. Growers will establish and manage a commercial plantation of '*Pinus Radiata*' and carry on a commercial business of afforestation during the term of the Project.
24. The Project will be terminated after 'Clear Fell' of the 'Trees', a period of approximately 25 years.

Constitution

25. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Growers and manage the Project. It operates as a deed binding all the Growers and WFL. Growers are bound by the Constitution by virtue of their participation in the Project.
26. Woodlots are taken to be issued when the Manager accepts the application. The Manager is required to notify the 'Applicant' in writing of such acceptance within 30 days of the issue of the Woodlots (clauses 4.5 and 4.7).
27. Where the application is accepted, the Manager will provide the Grower with at least 2 copies of each of the Forestry Management Agreement and the Lease Agreement or, if applicable, a Pre-Lease Agreement.

28. As soon as practicable after the issue of the Woodlots, the Manager must use its best endeavours to create and grant, a Forestry Right in respect of the 'Land' on which Woodlots are located to a third party who acts as an agent for the benefit of all the Growers who have acquired Woodlots on that 'Land'.

29. Among other things, the Constitution sets out in detail the following:

- powers, rights and liabilities of the Manager (clause 6 and 7);
- remuneration and expenses of the Manager (clause 10);
- stocking Guarantee (clause 12);
- insurance (clause 13);
- harvesting and sale of 'Trees' (clause 14);
- convening meetings of Growers and voting requirements (clause 16); and
- complaints procedures (clause 23).

Compliance Plan

30. As required by the *Corporation Act 2001*, WFL has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that WFL, as the Manager, complied with its obligations and responsibilities under the *Corporations Act 2001* and the Constitution. The Compliance Plan is designed to protect the interests of the Growers.

Forestry Management Agreement

31. Each Grower will enter into a Forestry Management Agreement with WFL. Under the Forestry Management Agreement, a Grower contracts with WFL to carry out such services as required to prepare, plant and maintain the Grower's 'Leasehold Property' until maturity at, approximately, Year 25.

32. In accordance with good forestry practices WFL will use all reasonable endeavours to carry out its obligations specified in the Part 1 and Part 2 of Schedule 1 of the Forestry Management Agreement in respect to the 'Leasehold Property'.

33. The Part 1 services, listed in Schedule 1 of the Forestry Management Agreement, are for 'Preparation and Planting' and will be provided to the Grower within the first 12 months from the date that the Grower is accepted into the Project. This product ruling will not apply to any Growers where WFL fails to complete the Part 1 services within 12 months of the Grower's acceptance into the Project.

34. The Part 2 services are for 'Maintenance', which includes 'Establishment Work', 'General Maintenance' and 'Sundries' services specified in Schedule 1 of the Forestry Management Agreement. They will be provided after the completion of the Part 1 services to 'Clear Fell' of the 'Trees' in Year 25.

35. The Responsible Entity provides a 'Stocking Guarantee' for a period of 2 years (called the 'Guarantee Period') from the date that the Grower is registered as the holder of a Woodlot on the terms and conditions set out in the Constitution.

36. During the 'Guarantee Period' the Manager will remove 'Trees' that are 'Materially Damaged', prepare the ground, and acquire and plant new seedlings. 'Trees' will be 'Materially Damaged' when, other than in certain specified circumstances set out in the Constitution, they are damaged or destroyed.

37. Under clause 7 of the Forestry Management Agreement, the harvesting and sale of the Growers' 'Trees' are to be carried out, or arranged to be carried out, by the Responsible Entity unless the Responsible Entity is otherwise notified by the Grower in accordance with the procedure set out in the PDS.

38. The Responsible Entity is responsible for insuring the 'Leasehold Property' against public risk for an amount of not less than \$10,000,000 during the life time of the Project.

Lease Agreement

39. An unregistered lease is granted by WFL (the 'Lessor') to each Grower (the 'Lessee') upon the acceptance of the application. The term of the lease is 25 years with an option for further 5 years or, until such time as the 'Trees' have been harvested and the 'Land' made good, whichever is the sooner.

40. The Lessor will create, or ensure to create a forestry right over the 'Land' described in the Lease Agreement, for the benefit of the Growers who have leased the 'Land'.

41. As a consideration for the rent during the 'Term' of the Project the Lessee will pay to the Lessor 2% of their 'Gross Timber Proceeds' received from the 'Thinnings' and 'Clear Fell' of the 'Trees' on the Woodlots.

42. Among other things, the Lease Agreement also sets out in detail the following matters:

- the Lessee may use the 'Land' only as part of a managed investment scheme under which Growers, including the Lessee, participate in the establishment and maintenance of the 'Trees', clause 1(a);

- at the expiration of the lease, the Lessee shall deliver up the 'Land' in such state of repair as is reasonable having regard to the terms and conditions of this lease, clause 4;
- the Lessee agrees not to do or permit anything to be done on the 'Land' or keep anything therein which may in any way invalidate or violate the conditions of any insurance policies relating thereto or increase or cause to be increased the premiums payable in respect thereof, clause 7; and
- the Lessee will permit the Lessor at all reasonable times to enter upon the 'Land', clause 10.

Forestry Right Agreement

43. The Grower who is granted an unregistered lease will also be granted a Forestry Right over the 'Land' by the Grantor, who is, or is entitled to be the registered proprietor of the title of the 'Land'. Under the Forestry Right Agreement the Grower has a secured interest in the 'Land' and is able to use the 'Land' for the purpose of conducting the afforestation business, including the right to harvest the 'Trees' grown on the 'Land'.

44. The Forestry Right is held by Willmott Forests Investment Management Pty Ltd (the 'Grantee'), a wholly owned subsidiary of the Responsible Entity, which acts as an agent on the Grower's behalf. The Forestry Right is registered with the applicable land titles office and provides protection for the Grower's 'Leasehold Interest' over the 'Land'.

Pre-Lease Agreement

45. Where there is no 'Land' is immediately available for Willmott to grant a 'Lease' to the Grower on or before 30 June 2006, the Grower will be required to enter into a Pre-Lease Agreement with Willmott.

46. Pursuant to the terms of the Pre-Lease Agreement Willmott undertakes to take all reasonable steps to grant a 'Lease' in respect of the Grower's Woodlots no later than a date being 9 months from the date on which Willmott accepts the Grower's application.

47. Where Willmott has not been able to grant a 'Lease' and Forestry Right to the Grower in respect of the Grower's Woodlots within 9 months then either party may terminate the agreement by providing 7 days prior written notice. Within 14 days of the receipt or service of the notice Willmott must (except in an event of default) refund any of the Grower's 'Application Monies' paid in respect of the application.

Fees

48. Under the Part 1 of the Schedule 1 of the Forestry Management Agreement, a Grower who is accepted to participate in the Project on or before 30 June 2006, must pay the Manager a management fee of \$3,850 per Woodlot upon the acceptance of their application, unless one of the Terms Agreement options, set out in paragraph 61, is entered into with WFL.

Note: Clause 4.2 of the Constitution also allows a Grower to make a payment by transferring property to the Manager. Growers who make a payment by transferring property to the Manager cannot rely on this Product Ruling. Such Growers may apply for a private ruling on the tax consequences of their participation in the Project.

49. WFL may charge interest at the 'Penalty Interest Rate' on any amount payable and outstanding which is not paid by the due date.

50. There are no ongoing payments for rent and maintenance. Instead, in return for providing the Part 2 services under the Forestry Management Agreement and for rental charges under the Lease Agreement, the Manager will be entitled to a fee of 9% of the 'Gross Timber Proceeds' from 'Thinnings' and 'Clear Fell' of the 'Trees' on the Woodlots. This is to be paid as and when the 'Trees' are thinned, or clear felled, and sold and will be deducted by the Manager from the 'Gross Timber Proceeds' prior to being distributed to Growers.

51. Where a Grower receives payments of insurance claims in respect of damage, or destruction of, all or any 'Trees' on the Woodlots under an insurance policy, the Grower must pay 9% of the insurance proceeds to the Responsible Entity within 14 days of their receipt to discharge their liabilities under the Forestry Management Agreement and Lease Agreement.

52. Under the Forestry Management Agreement, Growers who engage the Manager to carry out the harvesting and sales of the 'Trees' are liable for a 'Harvesting Fee' totalling 1 % of the 'Gross Timber Proceeds'. The 'Harvesting Fee' will be deducted by the Manager from the 'Gross Timber Proceeds' prior to being distributed to Growers.

Pooling of 'Trees' and distribution of proceeds

53. The PDS sets out the circumstances relating to the pooling of Growers' 'Trees' and the distribution of proceeds from the sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Trees' from a harvested 'Woodlot' to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and

- 'Trees' can only be pooled with the 'Trees' of Growers accepted to participate in the Project in the same financial year.

Application Form

54. Under the Application Form that forms part of the PDS, Growers who are accepted to participate in the Project grant WFL an irrevocable power of attorney. This allows WFL to execute and deliver the 'Project Documents', which consist of the Lease Agreement (and/or, if applicable, the Pre-lease Agreement) and the Forestry Management Agreement. The power of attorney begins from the date of the application being signed, to the expiration of the 'Project Documents'.

55. The Application Form also provides Growers with an opportunity to elect to opt out of harvesting and marketing arrangement for the 'Trees' with the Manager. Growers who make this election are not be covered by this Product Ruling and may seek a private ruling on the tax consequences of participating in the Project.

56. Upon signing the Application Form a Grower who has not been approved to pay fees under a Terms Agreement acknowledges that the full fees for all 'Application Monies' is immediately due and payable.

57. The 'Application Monies' paid to WFL at the time of a Grower's application will be deposited into a trust account known as the Willmott Forests Limited Project – Application Account and will only be released and paid to WFL once the application is accepted.

Finance

58. Growers who do not pay the Part 1 services fee in full upon application and who do not receive approval to pay their fees under a 'Terms Agreement' (see below) can fund their investment in the Project themselves, or borrow from an independent lender. Financing arrangements, other than the 'Terms Agreements' set out below, are not covered by this Product Ruling. Growers who enter into such finance agreements may request a private ruling on the deductibility or otherwise of interest incurred under the agreement.

59. Growers cannot rely on any part of this Product Ruling if 'Application Monies', other than 'Application Monies' payable subject to a 'Terms Agreement', are not paid in full by 30 June 2006. Where an application is accepted by WFL 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 WFL by 30 June 2006.

Terms Agreements

60. A Grower who elects to, and is accepted to pay the 'Application Monies' on terms is required to execute a 'Terms Agreement'. Under the relevant 'Terms Agreement', the Borrower is required to pay an amount equal to the 'Application Monies', plus interest over the period agreed between the Grower and WFL.

61. 'Terms Agreements' for one, three, five, seven, and ten year terms are summarised in the following table:

Terms Agreement	Part Payment (per Woodlot)	Monthly Payments (per Woodlot)	Interest Rate
1 year	\$350	12 × \$291.67	Nil
3 years (Principal and Interest ('P&I'))	\$350	36 × \$112.52	Fixed at 9.75% p.a.
5 years (P&I)	\$350	60 × \$74.36	Fixed at 10.00% p.a.
5 years (includes 2 years Interest Only ('I.O.'))	\$350	24 × \$29.17 (I.O.) payments 36 × \$112.94 (P&I) payments	Fixed at 10.00% p.a.
7 years (P&I)	\$350	84 × \$59.01	Fixed at 10.50% p.a.
7 years (includes 3 years I.O.)	\$350	36 × \$30.63 (I.O.) payments 48 × \$89.61 (P&I) payments	Fixed at 10.50% p.a.
10 years (P&I)	\$350	120 × \$48.21	Fixed at 11.00 % p.a.
10 years (includes 5 years I.O.)	\$350	60 × \$32.08 (I.O.) payments 60 × \$76.10 (P&I) payments	Fixed at 11.00 % p.a.

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62. Under a 'Terms Agreement', the Borrower agrees to pay the 'Monies Owing' by 'Monthly Payments' on each 'Payment Date' in the manner indicated in the Application Form. The 'Monies Owing' are the balance of the 'Principal Amount', all interest and all other monies (including any 'Administration Fee') actually or contingently owing under the application or the Terms Agreement.

63. Other than the 'Part Payment' which is due within 90 days from the date the Borrower's application is accepted, the 'Monthly Payments' under a 'Terms Agreement' will commence on each 'Payment Date' agreed between WFL and the Borrower. The 'Interest Rate' is calculated on the 'Principal Amount', less the amount of the 'Part Payment'.

64. This Product Ruling will not apply to Growers who enter into finance arrangements with WFL that differs materially from the Terms Agreement provided to the Tax Office with the application for this Product Ruling.

65. The finance provided under a Terms Agreement is on a full recourse basis. Where a Borrower defaults on payment of any 'Monies Owing' as and when required, WFL will, in addition to its right to take legal action to recover the 'Monies Owing', be entitled to charge interest at the 'Penalty Interest Rate' on amounts outstanding, take possession of the 'Mortgaged Property' and do anything the law allows an owner or receiver or receiver and manager of the 'Mortgaged Property' could do, including improving, selling and leasing the 'Mortgaged Property'.

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 WFL or the Project 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 30 June 2006 and who have executed a Forestry Management Agreement and either a Lease Agreement or a Pre-Lease Agreement 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 Project has commenced.

69. This Ruling does not apply to Growers:

- who are excluded from the Ruling as described in the Class of Persons or the Arrangement sections of the this Product Ruling; or
- where the 'Trees' grown on the Growers' Woodlots are pooled other than under the principles set out in paragraph 53.

The Simplified Tax System ('STS')

Division 328

70. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where the Grower uses the cash accounting method.

Qualification

71. 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.

25% Entrepreneurs tax offset

Subdivision 61-J – ITAA 1997

72. For the first income year starting on or after 1 July 2005, Subdivision 61-J of the ITAA 1997 provides for a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable Income

Section 6-5

73. 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.

74. Other than Growers referred to in paragraph 75, for the 2005-06 income year and later years, a Grower will be assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is derived.

75. For the 2005-06 income year and later years, a Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is received.

Deductions for the management fee under the Part 1 of Schedule 1 of the Forestry Management Agreement and for interest under a Terms Agreement with WFL

Section 8-1

76. A Grower may claim, on a per Woodlot basis, tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses summarised in the Table below.

77. However, if for any reason, an amount shown or referred to in the table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' using the cash accounting method, then the amount is only deductible to the extent to which it has been paid, or has been paid for that Grower. Any amount or part of an amount shown in the Table 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 2006	Year ended 30 June 2007	Year ended 30 June 2008
Part 1 Management Fee	\$3850 See Notes (i), (ii) & (iii) below	Nil	Nil
Interest payable to WFL under Terms Agreements	Nil	As incurred (Non-STSTaxpayers & STSTaxpayers using accruals accounting) Or as paid (STSTaxpayers using cash accounting) See Notes (iv) & (v) below	As incurred (Non-STSTaxpayers & STSTaxpayers using accruals accounting) Or as paid (STSTaxpayers using cash accounting) See Notes (iv) & (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 115.
- (ii) The fee under the Part 1 of Schedule 1 of the Forestry Management Agreement is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 102 to 105) and is deductible under section 8-1 in the income year in which it is incurred where the Grower is **not an 'STSTaxpayer'** or where the Grower is an **'STSTaxpayer' using the accruals accounting method**. Where the Grower is an **'STSTaxpayer' using the cash accounting method** those amounts are deductible in full in the year that they are paid.
- (iii) If a Grower who is an **'STSTaxpayer' using the cash accounting method** has entered into a Terms Agreement with WFL to pay the Part 1 management fee by 'Monthly Payments' and the 'Part Payment' under a Terms Agreement, then the fee of \$3,850 will not be fully paid in the income year in which it is incurred. For these Growers the Part 1 management fee is only deductible to the extent to which it has been paid by, or has been paid for, the Grower (for example, to the extent of the 'Monthly Payments' and, or the 'Part Payment' paid in the relevant income year). Any amount or part of an amount of the Part 1 management fee which is not paid in the income year in which it is

incurred will be deductible in the year in which it is actually paid.

- (iv) Growers who enter into a Terms Agreement with WFL for payment of the Part 1 management fee over Three, Five, Seven and Ten year Terms will incur interest monthly, beginning from July 2006, as set out in the Terms Agreements. Such interest is deductible in the income year in which it is incurred where the Grower is **not an 'STS taxpayer'** or where the Grower is an **'STS taxpayer' using the accruals accounting method**. Where the Grower is an **'STS taxpayer' using the cash accounting method** those amounts are deductible in full in the year that they are paid.
- (v) The deductibility or otherwise of interest arising from finance arrangements entered into with financiers other than WFL is outside the scope of this Ruling. Growers who borrow from lenders other than WFL may request a private ruling on the deductibility of the interest incurred.

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

Section 35-55 – Exercise of Commissioner's discretion

78. A Grower who is an individual accepted into the Project by 30 June 2006 and, elects for the Manager to harvest and market their 'Trees' at the time they are accepted into the Project, may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2006 to 30 June 2030, or to the income year preceding the 'Clear Fell' of the 'Trees' grown on the Grower's Woodlots (whichever occurs sooner)**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

79. For a Grower who participates in the Project and incurs expenditure as required by the Forestry Management Agreement, and, if applicable, a Terms Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME to 82KZMF;
- 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?

80. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the Willmott Forests Project – 2006 Product Disclosure Statement must amount to the carrying on of a business of primary production.

81. Where there is a business, or a future business, the gross proceeds from the sale of the 'Trees' from the Woodlots 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.

82. For schemes such as that of the Willmott Forests Project – 2006 Product Disclosure Statement, 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.

83. 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 rights over the land (by licence) 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.

84. In this Project, each Grower enters into a Forestry Management Agreement and a Lease Agreement.

85. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of at least 0.5 of a hectare of land. The Lease Agreement 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 Project Manager to come onto to the land to carry out its obligations under the Forestry Management Agreement.

86. Under the Forestry Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain a Woodlot on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Woodlot on the Grower's behalf.

87. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the 'Trees' grown on the Grower's Woodlot.

88. 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.

89. 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 'Trees' that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

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

92. The Grower's degree of control over the Responsible Entity as evidenced by the Forestry Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Woodlot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect.

93. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the Willmott Forests Project – 2006 Product Disclosure Statement will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

95. Changes to the STS rules apply from 1 July 2005. 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 management fees under Part 1 of Schedule 1 of the Forestry Management Agreement

Section 8-1

96. Consideration of whether the management fees under the Part 1 of the Schedule of the Forestry Management Agreement 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.

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

Interest deductibility

Section 8-1

(i) Growers who pay fees under a Terms Agreement with WFL

98. Some Growers may finance their participation in the Project through a Terms Agreement with WFL. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the management fee under Part 1 of the Schedule 1 of the Forestry Management Agreement.

99. The interest incurred will be in respect of a Terms Agreement to finance the Grower's business operations – the cultivation and growing of the 'Trees' – that will continue to directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1 in the income year in which it is incurred (where the Grower is not an 'STS taxpayer' or is an 'STS taxpayer using the accruals accounting method) or the income year in which it is paid (where the Grower is a 'STS taxpayer' using the cash accounting method).

(ii) Growers who enter into finance arrangements with other finance providers

100. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance facility with a financial institution other than WFL is outside the scope of this Ruling. This Product Ruling only deals with arrangements where all details and documents have been provided to, and examined by the Tax Office.

Prepayment provisions

Sections 82KZL to 82KZMG

101. 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.

Section 82KZMG

102. Expenditure that meets the requirements of section 82KZMG is excluded from the application of the prepayment rules that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates a deduction for certain prepaid expenditure incurred under a plantation forestry managed agreement. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees. Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of its eligible service period (as defined in subsection 82KZL(1)), and by the end of the following income year.

Application of the prepayment provisions to this Project

Section 82KZMG

103. Under the Forestry Management Agreement, a Grower incurs a Part 1 Management Fee consisting of expenditure of \$3,850 that:

- is for 'seasonally dependent agronomic activities'; and
- meets the other requirement of section 82KZMG.

104. As the requirements of section 82KZMG have been met, a Grower who is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method can, therefore, claim an immediate deduction for the fee for the Part 1 services in the income year in which the fee is incurred.

105. A Grower who is an 'STS taxpayer' using the cash accounting method can claim an immediate deduction for the fee for the Part 1 services in the income year in which the fee is paid. However, if such a Grower makes payments for the fee under a Terms Agreement the fee can only be claimed as a deduction to the extent of amounts paid by, or paid for, the Grower during the relevant income year.

Sections 82KZME and 82KZMF

106. Under the arrangement to which this Product Ruling applies fees for rent under the Lease Agreement and fees under Part 2 of the Forestry Management Agreement are only payable when the 'Gross Timber Proceeds' from 'Thinnings' and 'Clear Fell' of the 'Trees' are received respectively on year 13, year 18 and year 25, or on proceeds received from insurance claims. Interest payable under each of the Terms Agreement is incurred and payable monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME to 82KZMF have no application to this Arrangement.

107. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project chose to prepay interest under a Terms Agreement with WFL, or chose or is required to prepay interest under a loan agreement with a lender other than WFL. Where such a prepayment is made, these prepayment provisions will also apply to 'STS taxpayers' using the cash accounting method because there is no specific exclusion contained in sections 82KZME that excludes them from the operation of section 82KZMF.

108. Growers who choose to prepay interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

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

Section 35-55 – Exercise of Commissioner's discretion

109. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 78 the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 *Income tax: Division 35 – non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

Therefore, a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

110. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

111. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

112. 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).

113. The Willmott Forests Project – 2006 Product Disclosure Statement will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 77 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.

114. 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 ‘Trees’. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There 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**

115. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 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:

PR 2005/100

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 97/11;
 TR 2001/14; TD 2003/12

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 82KZMG
- ITAA 1936 Pt IVA
- ITAA 1936 177A

- ITAA 1936 177C
 - ITAA 1936 177D
 - ITAA 1936 177D(b)
 - ITAA 1997 6-5
 - ITAA 1997 8-1
 - ITAA 1997 17-5
 - ITAA 1997 Div 27
 - ITAA 1997 Div 35
 - ITAA 1997 35-10
 - ITAA 1997 35-10(2)
 - ITAA 1997 35-55
 - ITAA 1997 35-55(1)(b)
 - ITAA 1997 Subdiv 61-J
- ITAA 1997 Div 328
 - ITAA 1997 Subdiv 328-F
 - ITAA 1997 Subdiv 328-G
 - TAA 1953 Pt IVAAA
 - Copyright Act 1968
 - Corporations Act 2001

Case references:

- Commissioner of Taxation v. Lau
(1984) 6 FCR 202; 84 ATC 4929;
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