



# ***PR 2005/116 - Income tax: TFS Sandalwood Project 2006 (Pre 30 June Growers)***

 This cover sheet is provided for information only. It does not form part of *PR 2005/116 - Income tax: TFS Sandalwood Project 2006 (Pre 30 June Growers)*

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



## Product Ruling

### Income tax: TFS Sandalwood Project 2006 (Pre 30 June Growers)

Contents	Para
<b>What this Product Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
<b>Ruling</b>	<b>69</b>
<b>Explanation</b>	<b>87</b>
<b>Example</b>	<b>137</b>
<b>Detailed contents list</b>	<b>138</b>

#### **Preamble**

*The number, subject heading, **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 IVA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

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

## No guarantee of commercial success

Potential participants may wish to refer to the Tax Office website at [www.ato.gov.au](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.

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 and how the product fits an existing portfolio. 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 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, 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.

## What this Product Ruling is about

---

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling, this arrangement is sometimes referred to as 'TFS Sandalwood Project 2006', or just simply as 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936;
- section 82KZMG of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Unless otherwise stated, all legislative references that follow are in relation to the 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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

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

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

### **Class of persons**

7. The class of persons to whom this Ruling applies is the persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (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;
- Growers who elect to market their own produce (see paragraphs 22 and 70);
- Growers where a conditional allotment has been made under clause 11.5 of the Constitution and the approval process of an application subject to finance has not been completed by 30 June in the year of application (see paragraph 67); and
- Growers who enter into finance arrangements with entities associated with this Project, other than those specified in paragraphs 65 to 66.

### **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.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration  
Copyright Law Branch  
Attorney-General's Department  
Robert Garran Offices  
National Circuit  
BARTON ACT 2600

or posted at: <http://www.ag.gov.au/cca>

## Date of effect

---

11. This Ruling applies prospectively from 7 December 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 yet begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

---

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 specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

---

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

- Application for Product Ruling as constituted by documents received on 27 September 2005, 13 October 2005, 14 October 2005, 2 November 2005, 8 November 2005, 18 November 2005 and 23 November 2005, plus additional correspondence from the Applicant dated 14 October 2005, 31 October 2005, 2 November 2005, 8 November 2005, 18 November 2005 and 23 November 2005;
- Draft Product Disclosure Statement to be issued by T.F.S. Properties Ltd ('Responsible Entity'), received 23 November 2005;
- Draft **Lease and Management Agreement** (LMA) between T.F.S. Properties Ltd (in its capacity as both 'Responsible Entity' and 'Head Lessor'), T.F.S. Leasing Pty Ltd ('Lessor') and the Grower, received 18 November 2005;
- Draft **Agreement for Sub-Lease** between T.F.S. Properties Ltd ('Responsible Entity'), T.F.S. Leasing Pty Ltd ('Lessor') and the Grower, received 14 October 2005;
- Draft Constitution of the TFS Sandalwood Project 2005, received 14 October 2005;
- Draft Compliance Plan for the TFS Sandalwood Project 2005, received 27 September 2005;
- Draft Plantation Management Agreement between T.F.S. Properties Ltd ('Responsible Entity') and Tropical Forestry Services Ltd ('Manager'), received 27 September 2005;
- Additional correspondence received 29 and 31 May 2006 and 12 June 2006;
- Draft Further Supplementary Product Disclosure Statement of the TFS Sandalwood Project 2006, received 12 June 2006;
- Draft Terms Agreement between T.F.S. Properties Ltd ('Responsible Entity') and the Grower, received 27 September 2005; and
- Draft **Loan Agreement** between Arwon Finance Pty Ltd ('the Lender') and 'the Borrower', received 27 September 2005.

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

16. 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 TFS Sandalwood Project 2006 arrangement are as follows:

Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing and cultivation of Indian Sandalwood ( <i>Santalum album</i> ) trees for the purpose of harvesting and selling timber.
Number of hectares available for cultivation under this offer	350
Size of each leasehold area	0.5 hectare
Number of Sandalwood trees per hectare	Approximately 444
The term of the Project	Up to 15 years
Initial cost	\$35,750
Initial cost per hectare	\$71,500
Ongoing costs	Lease and Management Fees (may be prepaid, paid annually or deferred on an annual basis). Optional insurance premiums.
Other costs	Harvesting costs, Selling and Marketing Fee and Incentive Fees payable from harvest proceeds.

18. The Project will be a Managed Investment Scheme under the *Corporations Act 2001*. T.F.S. Properties Ltd will be the Responsible Entity of the Project. T.F.S. Properties Ltd has been issued with Financial Services Licence Number 241192 by ASIC. Growers participating in the arrangement will enter into a Lease and Management Agreement ('LMA'). The Project provides for the Lease of the 'Project Land' in the Ord River Irrigation Area in Kununurra, Western Australia, described as:

- Voyagers Farm, Farm Hill Road, via Kununurra (specifically Lot 240 on deposited plan 29468 and Lot 257 on deposited plan 209747); and
- King Location 384, Packsaddle Road, Kununurra.

19. This offer is for 350 hectares representing 700 Sandalwood Lots. This is the seventh stage of a Project that commenced in the Kununurra area under previous offers from the Responsible Entity. There is no minimum subscription for the Project.

20. Growers who have their 'Applications' accepted on or before 30 June 2006 will commence participation as Pre 30 June Growers. **This Ruling only applies in respect of these Pre 30 June Growers.**

21. A Grower will sub-lease a portion of the land called a 'Sandalwood Lot' for a period of approximately 15 years. Growers will enter into a contract with the Responsible Entity to have their Sandalwood Lot planted with Sandalwood seedlings and host plants for eventual harvest and sale. The Sandalwood Lots are separately identified by a reference number on a plan of the plantation annexed to the Lease and Management Agreement. Growers will receive a certificate for the Sandalwood Lots acquired.

22. T.F.S. Properties Ltd is responsible for establishing and cultivating the Growers' trees and the harvesting of the timber. Harvesting of the trees is expected to be completed in the 14th year after the Establishment Period. Upon application, a Grower may elect to take their Forest Yield ('Electing Grower') or T.F.S. Properties Ltd will sell the produce on their behalf ('Non-Electing Grower'). This Ruling does not apply to Electing Growers.

23. Upon application, Growers will also execute a Power of Attorney enabling T.F.S. Properties Ltd to act on their behalf as required.

### **Constitution**

24. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which T.F.S. Properties Ltd agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 26 of the Constitution, the Responsible Entity will keep a register of Growers.

25. Under the terms of the Constitution, all moneys received from applications shall be deposited into an Application Fund. The Application Moneys will be released when the Responsible Entity is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 13 and 14 of the Constitution).

26. The proceeds of the sale of timber of Non Electing Growers will be paid directly to the Responsible Entity who must deposit them into a Proceeds Fund. The Net Proceeds of Sale (after deductions) must be paid directly to each Non Electing Grower (see paragraph 64). The terms 'Proceeds Fund' and 'Net Proceeds of Sale' are defined in clause 1 of the Lease and Management Agreement.

## **Compliance Plan**

27. As required by the Corporations Act, a Compliance Plan has been prepared by T.F.S. Properties Ltd. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

## **Lease and Management Agreement**

28. Growers participating in the arrangement will enter into a Lease and Management Agreement ('LMA') with T.F.S. Properties Ltd (in its capacity as both 'Responsible Entity' and 'Head Lessor') and T.F.S. Leasing Pty Ltd ('Lessor'). Growers are granted an interest in land in the form of a sub-lease to use their Leased Area for the purpose of conducting their afforestation business until the final distribution of the sale proceeds is made to the Grower or until the Project is terminated.

29. Each Grower must pay rent to the Lessor for each year of the Project beginning from the financial year following the end of the Establishment Period.

30. The conditions of the sub-lease are outlined in clause 5 of the Agreement. Some of the conditions of the sub-lease are that the Grower:

- must not use the Leased Area or permit the Leased Area to be used for a purpose other than that of commercial silviculture of Sandalwood trees; and
- is not entitled to use the Leased Area for the purpose of permanently or temporarily residing on it or for residential, recreational or tourist purposes.

31. The Agreement also provides that each Grower appoints the Responsible Entity to perform services under the agreement. The services to be performed are specified in the definitions of 'Establishment Services', 'Ongoing Services' and 'Selling and Marketing Services' which are listed at Items 7A, 7B and 7C respectively of the Schedule to the Agreement.

32. The Establishment Services will be provided during the Establishment Period.

33. The Establishment Period is the period of 12 months from the Commencement Date.

34. The Responsible Entity will supervise and manage all silvicultural activities on behalf of each Grower including, but not limited to, the provision of the following services. The Commencement Date is the date upon which a Grower's Application is accepted by the Responsible Entity.

***Establishment services***

- acquire appropriate seeds and seedlings;
- carry out weed control, surveying and ground preparation of the Leased Area as required in respect of planting;
- plant Sandalwood seedlings or trees on the Leased Area, in accordance with good silvicultural and forestry practices, at a rate sufficient to provide an average survival rate of 444 trees per hectare at the end of the third year after the commencement date; and
- plant other trees (hosts) as it may consider to be necessary to enable or encourage the growth of the Sandalwood seedlings or trees.

***Ongoing services***

- irrigate, cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the trees;
- maintain the Leased Area according to good silvicultural and forestry practices;
- replant the relevant parts of the Plantation with sufficient seedlings or trees if the Responsible Entity deems necessary, with the replanting fee to be paid by the Responsible Entity;
- keep access roads, firebreaks and the Leased Area in good repair and free from vermin; and
- furnish to the Grower reports as and when required.

***Harvesting, selling and marketing services***

- carry out or arrange to be carried out the harvesting and processing of the Trees;
- supervise and manage the writing of a marketing plan;
- maintain an international database of all potential buyers of Sandalwood in the years preceding the Harvest; and

- supervise and manage the negotiating and making of sales of Forest Produce at the maximum practicable price available.

**Agreement for Sub-Lease**

35. Where the Responsible Entity has not already secured suitable land for the Project, it can still accept growers into the Project under the Agreement for Sub-Lease Agreement. Under this Agreement, the Responsible Entity must secure suitable land and arrange for the Grower to enter into a sub-lease with the Lessor in sufficient time for the Responsible Entity to perform the Establishment Services within the 12 months period from the date of acceptance of the application.

**Fees**

36. Lease and management fees are payable by the Grower for each Sandalwood Lot. The amounts payable to the Responsible Entity are set out under Items 9A, 9B, 9C and 9D of the Schedule to the Lease and Management Agreement. Joint Venture Growers (see paragraphs 58 to 60) will pay the relevant fees as described in paragraph 59.

***Establishment Fees***

37. Establishment Fees are payable per Sandalwood Lot on application for the Establishment Period, as follows:

<b>Number of Sandalwood Lots applied for</b>	<b>Establishment Fee</b>
1st Sandalwood Lot	\$35,750
2nd and each subsequent Sandalwood Lot	\$33,000

38. The full amount of the Establishment Fee, as set out in the Table in paragraph 37, is payable on Application.

39. The Responsible Entity is also offering an Instalment Option in respect of the Establishment Fee whereby a Grower can pay 20% of the Establishment Fee on application and the remainder of the Fee by instalments to be paid within 12 months after application as agreed by the Responsible Entity.

40. A Grower who chooses to pay by the Instalment Option must complete an Instalment Option Application and a Direct Debit Request for the Instalment payments. A Terms Agreement will be executed by the Responsible Entity.

41. Payments pursuant to the Instalment Option are paid by direct debit. If a Grower does not pay the required instalments under the Terms Agreement, then provided T.F.S. Properties Ltd has given the Grower 14 days written notice to remedy the situation and payment has still not been made, the balance owing under the Terms Agreement will become immediately due and payable. In addition T.F.S. Properties Ltd may take legal action to recover the amount, take possession of the secured property whereupon the Grower ceases to be a Grower in the Project or do anything an owner of the secured property is entitled to do.

42. The Responsible Entity will monitor the level of applications received under the Instalment Option and is not obliged to accept all Instalment Option Applications. A limit may be imposed on the number of applications that can be accepted under the Instalment Option. Applications for the Instalment Option will be reviewed on an Application by Application basis.

#### ***Ongoing lease and management fees***

43. There are 3 payment options for lease and management fees which are payable for the balance of the term of the Project after the Establishment Period. This Ruling has no application where a Grower enters into an arrangement to pay fees other than pursuant to the three options set out in paragraphs 44 to 55. Unless the Grower elects to prepay fees at the time of application they will be deemed to have elected to pay fees annually.

#### ***Option 1 – annual payment of lease and management fees***

44. For each financial year commencing after the financial year in which the Establishment Period ends, an Annual Fee of \$4,125 per Sandalwood Lot is payable in consideration of the Responsible Entity performing the Ongoing Services under Item 7B of the Schedule to the Lease and Management Agreement.

45. The fee will be indexed in each financial year following the first year at 2% per annum. The Annual Fee is payable on or before 14 January in each financial year for 12 years following the financial year in which the Establishment Period ends.

46. Rent is payable by the Grower to the Lessor for each year of the Project commencing after the financial year in which the Establishment Period ends. The amount of Rent is \$825 per year, indexed in each financial year following the first year at 2% per annum. Rent is payable annually on or before 14 January for 12 years following the financial year in which the Establishment Period ends.

47. The Responsible Entity will invoice the Grower on 1 January in each financial year for the Annual Fee and the Rent.

48. The Annual Fee for Year 13 will be deducted from the Gross Proceeds of Sale if harvesting is carried out according to the Harvest Plan. No Annual Fee will be charged in the final year of Harvest.

49. The Rent for Years 13 and 14 will be deducted from the Gross Proceeds of Sale if harvesting is carried out according to the Harvest Plan.

***Option 2 – prepayment of lease and management fees***

50. Growers may elect on application to prepay all Annual Fees and Rent due for the life of the Project after the Establishment Period. Under this option, one payment of \$33,330 for the Annual Fee and Rent up to Year 12 is payable by 14 January in the financial year after the Sandalwood Lot is planted. The Responsible Entity will invoice the Grower on 1 January for this payment.

51. The Annual Fee for Year 13 and the Rent for Years 13 and 14 will be deducted from the Gross Proceeds of Sale if harvesting is carried out according to the Harvest Plan.

***Option 3 – annual deferment of lease and management fees***

52. Growers who elect to pay the Annual Fee and Rent on an annual basis may also elect to defer these fees for any particular financial year after the end of the Establishment Period until harvesting is carried out under the Harvest Plan. This option is only available where the Grower has not utilised Arwon Finance or has paid out Arwon Finance previously used in respect of a Sandalwood Lot.

53. The Responsible Entity will monitor the number of elections to defer these fees and will not be obliged to accept all applications to defer fees. The Responsible Entity will determine the number of deferred fees it will accept after the period for subscribing to the Project has closed.

54. Where a Grower's Annual Fee and Rent is deferred, a percentage of the Gross Proceeds of Sale, as set out in the following Table, is payable to the Responsible Entity for each year that fees are deferred.

Financial Year of Deferral	Percentage of Gross Proceeds of Sale to which Responsible Entity is entitled
Years 1-6	4% per year
Years 7-10	3% per year
Years 11-12	2% per year

55. If all, or substantially all of the trees are destroyed before the Harvests can take place, the Grower will be liable to pay an amount equal to 55% of the annual lease and management fees for all years that would have otherwise been payable by an annual Grower up to the time the trees were destroyed.

#### **Other fees**

56. The Grower is also required to pay the following amounts to the Responsible Entity:

- the Grower's Proportional Share of the costs of Harvest and Processing (clause 18.2 of the LMA);
- a Selling and Marketing Fee, if applicable (see paragraph 64), equal to 5.5% of the Gross Proceeds of Sale (clause 18.2 of the LMA); and
- an Incentive Fee of an amount equal to 36.3% of the excess of the Net Proceeds of Sale per Sandalwood Lot over the amount estimated by the Responsible Entity (clause 19.4 of the LMA).

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

#### **Joint Venture**

58. The Project will also allow two Growers to enter into a Joint Venture. They will be bound by the Joint Venture Terms set out in the Joint Venture Growers Application Form attached to the Product Disclosure Statement. The Joint Venture option is available for both the Annual Payment Option and the Pre-paid Payment Option.

59. Under this Joint Venture:

- the first Joint Venture Grower will be responsible for procuring the preparation and establishment of the Sandalwood Lot by payment of the Establishment Fee; and
- the second Joint Venture Grower will be responsible for procuring the ongoing provision of land and maintenance of the Sandalwood Lot by payment of the Pre-paid Fee (in the case of the Pre-paid Option) or the Annual Fee and the Rent (in the case of the Annual Option).

60. The Joint Venture Terms provide that each Joint Venture Grower will be entitled to 50% each of the Joint Venture Property and, in particular, of all saleable timber from the Sandalwood Lots.

## Harvesting and sale

61. Harvesting and processing must be completed before 31 December in the 14th Year after the end of the Establishment Period. The Responsible Entity must arrange for a suitably qualified person to harvest and process the trees at market rates in accordance with a Harvest Plan. The Harvest Plan is based on when the Sandalwood trees are expected to achieve a heartwood content of 25kg to 27.5kg per tree. Although the Harvest Plan may be amended, harvesting is expected to be undertaken according to the following schedule:

- Year 13 – 20% of the Plantation; and
- Year 14 – 80% of the Plantation.

62. At all times the Non-Electing Grower (see paragraph 22) has full right, title and interest in the Forest Produce and the right to have the Forest Produce sold for their benefit (clause 16.1 of LMA). The Responsible Entity will sell the Forest Produce on behalf of the Non-Electing Growers for the maximum practicable price available (clause 17.1 of LMA and Item 7C of Schedule to LMA).

63. The Gross Proceeds of Sale from the Forest Produce of Non-Electing Growers will be paid direct to the Responsible Entity which must deposit them into a Proceeds Fund (clause 18.1 of LMA). Separate Proceeds Funds will be created for each category of Grower defined in this Ruling.

64. Within 10 days of receiving the Gross Proceeds of Sale, the Responsible Entity must pay to itself the Non-Electing Grower's Proportional Share of the costs of harvesting, processing, marketing and sale (clause 18.2 of LMA). Within a further 5 business days, the Responsible Entity will pay to itself any other fees or amounts owing and distribute the remainder to the Non-Electing Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Non-Electing Growers' Proportional Share' are defined in clause 1 of the Lease and Management Agreement.

## Finance

65. Growers may fund their participation in the Project themselves or borrow from an independent lender. All Growers can choose to borrow from Arwon Finance Pty Ltd (a lender associated with the Responsible Entity) to fund their establishment fees. Arwon Finance Pty Ltd is also available to pre-paid Growers to finance their prepaid fees amount and to annual Growers to finance their Years 1 to 3 Lease and Management fees.

66. Arwon Finance Pty Ltd will lend on a full-recourse commercial basis only to the extent it has funds available to lend to Growers. The finance available from Arwon Finance Pty Ltd is under the following arrangement:

Term	up to 10 years from the Date of Advance of the Principal Sum
Interest Rate	the relevant Bill Rate as quoted in the Interest Rate section of The Australian Financial Review PLUS up to 6% per annum accruing daily as calculated by the Lender
	<ul style="list-style-type: none"> <li>• a minimum deposit of 20% except for Growers who have fully paid Establishment Fees as part of the Pre-Paid Option;</li> <li>• regular monthly repayments of principal and interest commencing on Date of Advance of the Principal Sum and with the final payment of all outstanding amounts at the end of the Term of the Loan;</li> <li>• the loan is secured by a mortgage over the Grower's Leased Area and Project interest;</li> <li>• application fee of \$250; and</li> <li>• Stamp Duty fees at cost.</li> </ul>

67. The Constitution allows for the acceptance of Applications and allotment of Sandalwood Lots where the Application is subject to finance approval by a lending institution. Growers accepted in these circumstances will be excluded from this Ruling where the full amount of Application Money is not paid by 30 June in the year of Application.

68. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Arwon Finance Pty Ltd, are involved or become involved, in the provision of finance for the Project.

## Ruling

---

### Application of this Ruling

69. This Ruling applies only to Non-Electing Growers who are accepted to participate in the Project on or before 30 June 2006 (Pre 30 June Growers) where the Grower has executed a Lease and Management Agreement on or before that date.

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

- Growers who make an election to market timber produced from their Sandalwood Lots;
- Growers accepted into the Project where the approval process of an application subject to finance has not been completed by 30 June in the year of application and the full amount of Application Money has not been paid by 30 June in the year of Application; or
- Growers who enter into finance arrangements with entities associated with this Project, other than those specified in paragraphs 65 to 66.

### The Simplified Tax System (STS)

#### *Division 328 of the ITAA 1997*

71. 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**

72. 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*

73. 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 and section 328-105**

74. 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 of the ITAA 1997), will be assessable income of the Grower under section 6-5 of the ITAA 1997.

75. A Grower will recognise ordinary income from carrying on the business of afforestation at the time that income is derived when they are:

- not an 'STS taxpayer'; or
- an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years.

76. 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.

77. A Grower may operate in its own right in relation to an identified area of land, or in Joint Venture with another Grower as referred to in paragraphs 58 to 60.

**Deductions for management fees, lease fees, interest and borrowing expenses****Section 8-1 and section 328-105**

78. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses described at paragraphs 80 to 83.

79. 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' 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 the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

**Option 1 – annual payment of lease and management fees**

80. Where a Pre 30 June Grower (who is not a Joint Venture Grower, see paragraph 81) elects to pay fees annually, the deductions set out in the Table below will be allowable on a per Sandalwood Lot basis, **(unless the fees have been deferred, see paragraph 84)**:

Fee Type	ITAA 1997 Section	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
<b>Establishment Fee</b>	8-1	See Notes (i) & (ii)	Nil	Nil
<b>Annual Fee</b>	8-1	Nil	Nil	\$4,125 See Notes (i) & (iii)
<b>Rent</b>	8-1	Nil	Nil	\$825 See Notes (i) & (iii)
<b>Interest</b>	8-1	See Note (iv)	See Note (iv)	See Note (iv)
<b>Borrowing Expenses</b>	25-25	See Note (v)	See Note (v)	See Note (v)

**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 of the ITAA 1997. See Example at paragraph 137.

- (ii) The Establishment Fee is payable on application for services to be provided in the Establishment Period. It is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 112 to 116) and is deductible in the year in which it is incurred (where the Grower is **not an 'STS taxpayer' or is an 'STS taxpayer using accruals accounting'**) or the year in which it is paid (where the Grower is an **'STS taxpayer' using the cash accounting method**). The amount that is incurred will depend upon the number of Sandalwood Lots held by the Grower. These amounts are set out in the Table in paragraph 37 of this Product Ruling.

If a Grower who is an **'STS taxpayer' using the cash accounting method** chooses to pay the Establishment Fee under the Instalment Option, then the amount as set out in paragraph 37 will not be fully paid in the year in which it is incurred. For STS taxpayers using the cash accounting method, the Establishment Fee is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

- (iii) The Rent and the Annual Fee incurred by a Grower are deductible in the year in which they are incurred (where the Grower is **not an 'STS taxpayer' or is an 'STS taxpayer' using accruals accounting**) or the year in which they are paid (where the Grower is an **'STS taxpayer' using the cash accounting method**). However, **no deduction is available in a year in which the Rent and Annual Fee have been deferred** (refer to paragraph 84).
- (iv) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Arwon Finance Pty Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with Arwon Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 104 to 111 as those rules may be applicable if interest is prepaid. Interest paid to Arwon Finance Pty Ltd is deductible in the year in which it is incurred (where the Grower is **not an 'STS taxpayer' or is an 'STS taxpayer' using accruals accounting**) or the year in which it is paid (where the Grower is an **'STS taxpayer' using the cash accounting method**).

- (v) The Loan Application Fee and Stamp Duty are borrowing costs and are deductible under section 25-25 of the ITAA 1997. They are incurred for borrowing funds 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 Arwon Finance Ltd is outside the scope of this ruling.

### *Joint Venture Growers*

81. A Joint Venture Grower may claim the following deductions where fees have been paid annually:

- for the first Joint Venture Grower, fees in relation to the Establishment Services are set out in the Table at paragraph 37 and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (ii), (iv) and (v) above; and
- for the second Joint Venture Grower, fees in relation to the Annual Fee and Rent are set out in paragraphs 44 to 46 and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (iii), (iv) and (v) above.

### ***Option 2 – prepayment of lease and management fees***

82. Where a Pre 30 June Grower (who is not a Joint Venture Grower, see paragraph 83) elects to prepay all annual lease and management fees due for the life of the Project after the Establishment Period, the following amounts are deductible on a per Sandalwood Lot basis:

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2006</b>	<b>Year ended 30 June 2007</b>	<b>Year ended 30 June 2008</b>
<b>Establishment Fee</b>	8-1	See Notes (i) & (ii) above	Nil	Nil
<b>Prepaid Rent and Annual Fees</b>	8-1	Nil	Nil	See Note (vi) below
<b>Interest</b>	8-1	See Note (iv) above	See Note (iv) above	See Note (iv) above
<b>Borrowing Expenses</b>		See Note (v) above	See Note (v) above	See Note (v) above

**Notes:**

- (vi) The prepaid Rent and Annual fees described in paragraph 50 are **NOT** deductible in full in the year incurred (**non-'STS taxpayers' or 'STS taxpayers' using accruals accounting**) or the year in which they are paid by an **'STS taxpayer' using the cash accounting method**. The deduction for each year's fees **must** be determined using the formula in subsection 82KZMF(1) (see paragraph 110)). This subsection operates to apportion expenditure over the eligible service period or ten years, whichever is the lesser.

*Joint Venture Growers*

83. A Joint Venture Grower may claim the following deductions where the annual lease and management fees are pre-paid:

- for the first Joint Venture Grower, fees in relation to the Establishment Services are set out in the Table at paragraph 37 and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (ii), (iv) and (v) above and;
- for the second Joint Venture Grower, the fee for the Pre-paid Rent and Management Fees are set out in paragraph 50 and the deductions available for the fee, interest and borrowing costs (if applicable) are set out in Notes (iv), (v) and (vi) above.

***Option 3 – annual deferral of lease and management fees***

84. Where a Grower who has elected to pay the Annual Fee and Rent on an annual basis defers payment of those fees in any year, no amount for those fees has been incurred or paid in that year and **NO amount is deductible in that year**. The Establishment Fee is deductible as stated in Option 1 and Option 2 above.

## **Division 35 – deferral of losses from non-commercial business activities**

### ***Section 35-55 – exercise of Commissioner’s discretion***

85. A Grower who is an individual and is accepted into the Project during the year ended 30 June 2006 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10 of the ITAA 1997. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 for these Growers for the income years 30 June 2006 to 30 June 2019. 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 and 82KL and Part IVA***

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

- expenditure by the Grower does not fall within the scope of sections 82KZME and 82KZMF except where the Grower elects to prepay fees under Option 2 described above;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## **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 TFS Sandalwood Project 2006 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 timber from the scheme will constitute assessable income in their own right. The generation of ‘business income’ from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

89. For schemes such as that of the TFS Sandalwood Project 2006, 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 in the land (by lease) or holds rights over the land (by licence) on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

91. In this Project each Grower enters into a Lease and Management Agreement. Under this Agreement each individual Grower will have rights over a specific and identifiable area of at least 0.5 hectares of land. The 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 Agreement allows the Project Manager to come onto the land to carry out its obligations.

92. Under the Lease and Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain 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 leased area on the Grower's behalf.

93. The Responsible Entity is also engaged to harvest and sell, on behalf of the Grower, the timber grown on the Grower's leased area.

94. 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.

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

96. The pooling of timber grown on the Grower's Leased Area with the timber of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled timber will reflect the proportion of the trees contributed from their Leased Area.

97. 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 Sandalwood Lot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

98. The Grower's degree of control over the Responsible Entity as evidenced by the Lease and Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Leased Area 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.

99. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the TFS Sandalwood Project 2006 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328 of the ITAA 1997***

100. 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.

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

102. Consideration of whether the lease and management fees are deductible under section 8-1 of the ITAA 1997 begins with the first limb of the section. This view proceeds on the following basis:

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

103. The management fees and lease fees associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1 of the ITAA 1997. 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.

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

104. 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.

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

### **Sections 82KZME and 82KZMF**

106. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see paragraph 110) 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)).

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

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

108. 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 Arwon Finance Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction, are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

109. 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.

110. 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.

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

111. 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**

112. Under subsection 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).

113. 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
- is for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

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

- it must be an agreement for planting and tending trees for felling;
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and

- either:
  - a) there must be more than one participant in the agreement in the same capacity as the taxpayer who incurs the expenditure; or
  - b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

115. 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.

116. 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***

#### *Establishment Fee*

117. Under the Land and Management Agreement, a Grower incurs a fee for Establishment Services. This fee consists of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the expenditure is incurred under the Land and Management Agreement for 'seasonally dependent agronomic activities'.

118. A Grower who is an 'STS taxpayer' the using the cash accounting method can, therefore, claim an immediate deduction for the Establishment Fee in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method can claim an immediate deduction for the Establishment Fee in the income year in which the fee is incurred.

#### *Option 1 – annual payment of lease and management fees*

119. Under the Lease and Management Agreement, lease and management fees are payable annually, partly in advance, for the lease of the land during the same expenditure year. Under the loan agreements to be executed between Growers and Arwon Finance Pty Ltd interest is payable monthly in advance.

120. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 36 to 49, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

*Option 2 – prepayment of lease and management fees*

121. Growers may elect to prepay lease and management fees for 12 years after the end of the Establishment Period. For these Growers, the expenditure falls outside the scope of section 82KZMG, and the amount and timing of deductions for prepaid Lease and Management Fees, or prepaid interest (if applicable) will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The amount of the 'eligible service period' is restricted to a maximum of 10 years after the day of the expenditure.

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

122. Although not required under the Lease and Management Agreement for Option 1 above, or the Loan Agreement with Arwon Finance Pty Ltd, a Grower participating in the Project may choose to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Growers who use financiers other than Arwon Finance Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 120, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

**Interest deductibility**

***Section 8-1***

*(i) Growers who use Arwon Finance Pty Ltd as the finance provider*

124. Some Growers may finance their prepaid fees in the Project through a loan facility with Arwon Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 of the ITAA 1997 depends on the same reasoning as that applied to the deductibility of lease and management fees.

125. The interest incurred for the first year of participation and subsequent years of income will be in respect of a loan to finance the Grower's business operations – the cultivation and growing trees and the lease of the land on which the trees will have been planted – that will continue to be 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 of the ITAA 1997.

126. As with the management fees and the lease fees, in the absence of any application of the prepayment provisions (see paragraphs 104 to 111), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' using cash the accounting method or is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method.

127. If the Grower is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method, interest is deductible in the year in which it is incurred.

128. If the Grower is an 'STS taxpayer' using the cash accounting method interest is not deductible until it has been both incurred and paid, or is paid for the Grower. 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, or is paid for the Grower.

*(ii) Growers who DO NOT use Arwon Finance Pty Ltd as the finance provider*

129. 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 Arwon Finance Pty Ltd 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.

130. 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 104 to 111).

**Division 35 – deferral of losses from non-commercial business activities*****Section 35-55 – exercise of Commissioner’s discretion***

131. In deciding to exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 on a conditional basis for the income years **30 June 2006 to 30 June 2019** 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 years ended 30 June 2006 up to and including 30 June 2019:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- 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; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) of the ITAA 1997 until a later income year is able to offset that loss against their other assessable income.

132. The exercise of the Commissioner’s discretion under paragraph 35-55(1)(b) of the ITAA 1997 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**

133. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

**Part IVA – general tax avoidance provisions**

134. 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).

135. The TFS Sandalwood Project 2006 will be a 'scheme' commencing with the issue of the PDS. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 80 to 83 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

## Example

### Entitlement to GST input tax credits

137. 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 2004, 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 1/1/2005 to 30/6/2005	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2005 (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 2005, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

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

## Detailed contents list

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

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
Overview	17
Constitution	24
Compliance Plan	27
Lease and Management Agreement	28
Agreement for Sub-Lease	35
Fees	36
<i>Establishment Fees</i>	37
<i>Ongoing lease and management fees</i>	43
<i>Option 1 – annual payment of lease and management fees</i>	44

<i>Option 2 – prepayment of lease and management fees</i>	50
<i>Option 3 – annual deferment of lease and management fees</i>	52
<i>Other fees</i>	56
Joint Venture	58
Harvesting and sale	61
Finance	65
<b>Ruling</b>	<b>69</b>
Application of this Ruling	69
The Simplified Tax System (STS)	71
<i>Division 328 of the ITAA 1997</i>	71
<i>Qualification</i>	72
<i>25% entrepreneurs tax offset</i>	73
<i>Subdivision 61-J</i>	73
Assessable income	74
<i>Section 6-5 and section 328-105</i>	74
Deductions for management fees, lease fees, interest and borrowing expenses	78
<i>Section 8-1 and section 328-105</i>	78
<i>Option 1 – annual payment of lease and management fees</i>	80
<i>Joint Venture Growers</i>	81
<i>Option 2 – prepayment of lease and management fees</i>	82
<i>Joint Venture Growers</i>	83
<i>Option 3 – annual deferral of lease and management fees</i>	84
Division 35 – deferral of losses from non-commercial business activities	85
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	85
<i>Sections 82KZME, 82KZMF and 82KL and Part IVA</i>	86
<b>Explanation</b>	<b>87</b>
Is the Grower carrying on a business?	87
The Simplified Tax System	100
<i>Division 328 of the ITAA 1997</i>	100
Deductibility of lease and management fees	102
<i>Section 8-1</i>	102
Prepayment provisions	104
<i>Sections 82KZL to 82KZMG</i>	104

<i>Sections 82KZME and 82KZMF</i>	106
<i>Section 82KZMG</i>	112
<i>Application of the prepayment provisions to this Project</i>	117
<i>Establishment Fee</i>	117
<i>Option 1 – annual payment of lease and management fees</i>	119
<i>Option 2 – prepayment of lease and management fees</i>	121
<i>Growers who <u>choose</u> to pay fees for a period in excess of that required by the Project's agreements</i>	122
Interest deductibility	124
<i>Section 8-1</i>	124
(i) <i>Growers who use Arwon Finance Pty Ltd as the finance provider</i>	124
(ii) <i>Growers who DO NOT use Arwon Finance Pty Ltd as the finance provider</i>	129
Division 35 – deferral of losses from non-commercial business activities	131
<i>Section 35-55 – exercise of Commissioner's discretion</i>	131
Section 82KL	133
Part IVA – general tax avoidance provisions	134
<b>Example</b>	<b>137</b>
Entitlement to GST input tax credits	137
<b>Detailed contents list</b>	<b>138</b>

# PR 2005/116

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 92/1; TR 92/20; TR 97/11;  
TR 97/16; TR 98/22; TR 2000/8;  
TR 2001/14; TD 93/34;  
PR 1999/95; IT 360

*Subject references:*

- advance expenses and  
payments for certain forestry  
expenditure  
- carrying on a business  
- commencement of business  
- fee expenses  
- forestry agreement  
- interest expenses  
- management fees  
- producing assessable income  
- product rulings  
- public rulings  
- seasonally dependent  
agronomic activity  
- tax avoidance  
- tax benefits under tax avoidance  
schemes  
- tax shelters  
- tax shelters project  
- taxation administration

*Legislative references:*

- TAA 1953 Pt IVA  
- ITAA 1936 82KL  
- ITAA 1936 Pt III Div 3 Subdiv H  
- ITAA 1936 82KZL  
- ITAA 1936 82KZL(1)  
- ITAA 1936 82KZM  
- ITAA 1936 82KZMA  
- ITAA 1936 82KZMB  
- ITAA 1936 82KZMC  
- ITAA 1936 82KZMD

- 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 82KZMG(1)  
- ITAA 1936 82KZMG(2)  
- ITAA 1936 82KZMG(3)  
- ITAA 1936 82KZMG(4)  
- ITAA 1936 82KZMG(5)  
- 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 25-25  
- 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 328-105  
- ITAA 1997 Subdiv 328-F  
- ITAA 1997 Subdiv 328-G  
- Copyright Act 1968  
- Corporations Act 2001

*Case references:*

- Commissioner of Taxation v. Lau  
(1984) 6 FCR 202; 84 ATC 4929;  
(1984) 16 ATR 55

---

ATO references

NO: 2005/14594  
ISSN: 1441-1172  
ATOlaw topic: Income Tax ~~ Product ~~ timber