



# ***PR 2006/114 - Income tax: TFS Sandalwood Project 2006 (Post 30 June Growers)***

 This cover sheet is provided for information only. It does not form part of *PR 2006/114 - Income tax: TFS Sandalwood Project 2006 (Post 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 (Post 30 June Growers)

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**ⓘ This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

### **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 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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

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

### Relevant provision(s)

2. The relevant provisions 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;
  - section 25-25 of the ITAA 1936;
  - 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;
  - Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
  - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - section 82KZL of the ITAA 1936;
  - sections 82KZME to 82KZMG of the ITAA 1936; and
  - Part IVA of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

### Goods and services tax

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

**Changes in the law**

4. 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. Entities who are considering participating in the Scheme 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 entities in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that entities are fully informed of any legislative changes after the Ruling is issued.

**Class of entities**

7. The class of entities to whom this Ruling applies consists of the entities more specifically identified in the Ruling part of this Product Ruling, refer to paragraphs 80 and 81 of this Ruling and who enter into the scheme described below on or after the date this Ruling is made. They will have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement. In this Ruling, these entities are referred to as 'Growers'.

8. The class of entities to whom this Ruling applies does not include:

- those who are accepted to participate in the Project before 1 July 2006 and after 30 June 2007;
- entities who intend to terminate their involvement in the scheme prior to Project's completion or do not intend to derive assessable income from the Project;
- Growers who elect to market their own produce (see paragraphs 25 and 81 of this Ruling);
- 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; and
- Growers who enter into finance arrangements with entities associated with this Project, other than those specified in paragraphs 66 to 77 of this Ruling.

## Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 79 of this Ruling.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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12. This Ruling applies prospectively from 28 June 2006, 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

13. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

14. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

15. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

## Withdrawal

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16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provisions ruled upon, to all entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities involvement in the scheme.

## Scheme

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

- Application for Product Ruling as constituted by documents received on 27 September 2005, 13 and 14 October 2005, 2, 8, 18, 23 and 30 November 2005, 5 December 2005, 2, 24 and 31 May 2006 and 6, 12, 13, 15 and 20 June 2006 plus additional correspondence from the Applicant dated 14 and 31 October 2005, 2, 8, 18 and 23 November 2005, 5 December 2005, 2 March 2006, 2, 24 and 29 May 2006 and 6, 12, 13, 15 and 16 June 2006;
- Product Disclosure Statement of the TFS Sandalwood Project 2006, dated 28 November 2005;
- Draft Supplementary Product Disclosure Statement of the TFS Sandalwood Project 2006, received 2 May 2006;
- Draft Further Supplementary Product Disclosure Statement of the TFS Sandalwood Project 2006, received 12 June 2006;
- Draft **Lease and Management Agreement** ('LMA') between T.F.S. Properties Limited ('Responsible Entity'), T.F.S. Leasing Pty Limited ('Lessor') and the Grower, received 18 November 2005;
- Draft **Agreement for Sub-Lease** between the Responsible Entity, the Lessor and the Grower, received 14 October 2005;
- Draft Constitution of the TFS Sandalwood Project 2006, received 14 October 2005;

- Draft Compliance Plan for the TFS Sandalwood Project 2006, received 27 September 2005;
- Draft Plantation Management Agreement between the Responsible Entity and Tropical Forestry Services Limited ('Manager'), received 27 September 2005;
- Draft Terms Agreement between the Responsible Entity and the Grower, received 27 September 2005;
- Draft **Loan Agreement** between Arwon Finance Pty Limited ('Arwon Finance') and 'the Borrower', received 27 September 2005;
- **Finance Application Form** for Arrow Funding Pty Limited ('Arrow Funding') finance, received 24 May 2006; and
- Letter from Arrow Funding, titled, 'TFS Sandalwood Project 2006 ARSN 117 134 611 – External Finance Loan Products Offer by Arrow Funding under Preferred Terms' and dated 28 April 2006.

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

18. The documents highlighted (in bold) are those that Growers may enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other schemes, 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 scheme to which this Ruling applies.

19. 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

20. The salient features of the TFS Sandalwood Project 2006 scheme 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 Sandalwood Lot                                   | 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               | \$68,750                                                                                                             |
| Ongoing costs                          | Annual Fees and Rent (may be prepaid, paid annually or deferred on an annual basis).<br>Optional insurance premiums. |
| Other costs                            | Harvesting costs, Selling and Marketing Fee and Incentive Fees payable from harvest proceeds.                        |

21. The Project will be a Managed Investment Scheme under the *Corporations Act 2001*. T.F.S. Properties Limited will be the Responsible Entity of the Project. T.F.S. Properties Limited has been issued with Financial Services Licence Number 241192 by ASIC. Growers participating in the scheme will enter into a 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.

22. 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.

23. Growers who have their 'Applications' accepted on or after 30 June 2006 and on or before 30 June 2007 will commence participation as 'Post 30 June Growers'. **This Ruling only applies in respect of these Post 30 June Growers. Note that other Product Rulings may apply to Growers who enter the Project during the period on or after 7 December 2005 to on or before 30 June 2006.**

24. A Grower will sub-lease 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 LMA. Growers will receive a certificate for the Sandalwood Lots acquired.

25. The Responsible Entity will establish and cultivate the Growers' trees and the harvest 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 the Responsible Entity will sell the produce on their behalf ('Non-Electing Grower'). This Ruling does not apply to Electing Growers.

26. Upon Application, Growers will also execute a Power of Attorney enabling Responsible Entity to act on their behalf as required.

## **Constitution**

27. 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 Limited 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.

28. 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).

29. 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 63 of this Ruling). The terms 'Proceeds Fund' and 'Net Proceeds of Sale' are defined in clause 1 of the LMA.

## **Compliance Plan**

30. As required by the *Corporations Act 2001*, a Compliance Plan has been prepared by the Responsible Entity. 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**

31. Growers participating in the scheme will enter into a LMA with the Responsible Entity and T.F.S. Leasing Pty Limited ('Lessor'). Growers are granted an interest in land in the form of a sub-lease to use their Sandalwood Lot 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.

32. 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.

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

34. 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.

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

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

37. 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 Sandalwood Lot as required in respect of planting;
- plant Sandalwood seedlings or trees on the Sandalwood Lot, 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 Sandalwood Lot 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 Sandalwood Lot 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**

38. 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**

39. Annual Fees and Rent 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 LMA. Joint Venture Growers (see paragraphs 57 to 59 of this Ruling) will pay the relevant fees as described in paragraph 58 of this Ruling.

***Establishment Fees***

40. 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                 |

41. The full amount of the Establishment Fee, as set out in the Table in paragraph 40 of this Ruling, is payable on Application.

***Annual Fees and Rent***

42. There are 3 payment options for the Annual Fees and Rent 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 a scheme to pay fees other than pursuant to the three options set out in paragraphs 43 to 54 of this Ruling. 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 Fees and Rent***

43. 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 LMA.

44. 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.

45. 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.

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

47. 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.

48. 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 Annual Fees and Rent***

49. 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.

50. 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 Annual Fees and Rent***

51. 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.

52. 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.

53. 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                                                                  |

54. 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 Fees and Rent for all years that would have otherwise been payable by an annual Grower up to the time the trees were destroyed.

**Other fees**

55. 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 63 of this Ruling), 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).

56. 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 Sandalwood Lot 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**

57. 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.

58. 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).

59. 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

60. 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.

61. At all times the Non-Electing Grower (see paragraph 25 of this Ruling) 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).

62. 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).

63. 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 LMA.

## Finance

64. Each Grower can fund their involvement in the Project as follows:

- from their own financial resources;
- under the Instalment Option with the Responsible Entity;
- by borrowing from Arwon Finance Pty Limited ('Arwon Finance') (a lender associated with the Responsible Entity);
- by borrowing from Arrow Funding Pty Limited ('Arrow Funding'); or
- by borrowing from an independent lender.

65. These finance packages are summarised below.

***Instalment Option***

66. Under the Product Disclosure Statement, a Grower can choose to pay the Establishment Fee in full on the due date or pay the amount under the Instalment Option offered by the Responsible Entity. The following payments are due under this option:

- 20% of the Establishment Fee on Application; and
- the balance by 12 equal consecutive monthly instalments, commencing on the first day of the month after Application.

67. 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. The Responsible Entity will execute a Terms Agreement.

68. 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 the Responsible Entity 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, the Responsible Entity 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.

69. 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.

***Finance by Arwon Finance***

70. Growers can apply to borrow the Establishment Fee from Arwon Finance, by completing the Application Form.

71. Arwon Finance 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 is under the following arrangement:

- a minimum deposit of 20%, except for Growers who have fully paid Establishment Fees as part of the Pre-Paid Option;
- a term of up to 10 years from the Date of Advance of the Principal Sum;

- regular monthly repayments of principal and interest commencing on the 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;
- the interest rate being 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;
- application fee of \$250;
- the loan is secured by a mortgage over the Grower's Sandalwood Lot and Project interest; and
- Stamp duty fees at cost.

### ***Finance by Arrow Funding***

72. Growers can apply to borrow the Establishment Fee from the Arrow Funding, by completing the Finance Application Form.

73. Growers who enter into the finance arrangement are required to pay a minimum deposit of 10% of the subscription fee. The balance after the 10% deposit is repayable together with interest, under one of the following options:

- 7 year facility, 3 years interest only and then 4 years principal and interest; and
- 10 year facility, 3 years interest only and then 7 years principal and interest loan.

74. The repayments are due monthly over the term of the loan commencing on the last business day of the month that the Grower's loan proceeds are paid to the Responsible Entity.

75. The interest rate shall be 9.75% per annum for the 7 year facility and 10.25% per annum for the 10 year facility. However, Arrow Funding reserves the right to increase the rate should there be an upward shift in interest rates (subject to an alternative arrangement agreed with Responsible Entity).

76. An Application Fee of 1% of the loan amount is payable to Arrow Funding with the finance application, subject to, a minimum Application Fee of \$100 and Maximum Application Fee of \$500.

77. The loan will be secured by first ranking charge over the Grower's right, title and interest in the Sandalwood Lots and the Project documents. The loan is on a full recourse basis and recovery action will be taken in respect of any default.

***Other qualifications relating to finance arrangements***

78. The only finance arrangements covered by this Product Ruling is the Instalment Option, finance by Arwon Finance and the finance by Arrow Funding set out in paragraphs 66 to 77 of this Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under that finance arrangement not covered by this Product Ruling.

79. 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan terms are of a non-arm's length nature;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved, in the provision of finance to Growers for the Project, other than under the Instalment Option offered by the Responsible Entity, the finance offered by Arwon Finance and the finance offered by Arrow Funding, described in paragraphs 66 to 77 of this Ruling.

## **Ruling**

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**Application of this Ruling**

80. This Ruling applies only to Non-Electing Growers who are accepted to participate in the Project after 30 June 2006 and on or before 30 June 2007 (Post 30 June Growers) where the Grower has executed a LMA during this period.

81. 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 66 to 77 of this Ruling.

## **The Simplified Tax System (STS)**

### ***Division 328***

82. To be an 'STS taxpayer' a Grower must be eligible to be an STS taxpayer and must have elected to be an STS taxpayer (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where a Grower who was an STS taxpayer prior to the 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

83. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

## **25% entrepreneurs tax offset**

### ***Subdivision 61-J***

84. For the first income year starting on or after 1 July 2005, Subdivision 61-J 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**

85. 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), when derived will be assessable income of the Grower under section 6-5.

**Deductions for Annual Fees, Rent, interest and borrowing expenses****Sections 8-1 and 25-25**

86. A Grower may claim tax deductions under section 8-1, for the revenue expenses described at paragraphs 87 to 90 of this Ruling.

**Option 1 – Annual Fees and Rent**

87. Where a Post 30 June Grower (who is not a Joint Venture Grower, see paragraph 88 of this Ruling) 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 91 of this Ruling)**:

| <b>Fee Type</b>           | <b>Year ended<br/>30 June 2007</b> | <b>Year ended<br/>30 June 2008</b> | <b>Year ended<br/>30 June 2009</b> |
|---------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>Establishment Fee</b>  | See Notes (i) & (ii)               | Nil                                | Nil                                |
| <b>Annual Fee</b>         | Nil                                | Nil                                | \$4,125<br>See Notes (i) & (iii)   |
| <b>Rent</b>               | Nil                                | Nil                                | \$825<br>See Notes (i) & (iii)     |
| <b>Interest</b>           | Amount incurred<br>See Note (iv)   | Amount incurred<br>See Note (iv)   | Amount incurred<br>See Note (iv)   |
| <b>Borrowing Expenses</b> | 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.

- (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 119 and 123 of this Ruling) and is deductible in the year in which it is incurred. 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 40 of this Ruling.
- (iii) The Annual Fee and Rent incurred by a Grower are deductible in the year in which they are incurred. However, **no deduction is available in a year in which the Rent and Annual Fee have been deferred** (refer to paragraph 91 of this Ruling).
- (iv) The deductibility or otherwise of interest arising from finance arrangements other than the finance by Arwon Finance and Arrow Funding described at paragraphs 70 to 77 is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Arwon Finance or Arrow Funding should read the discussion of the prepayment rules in paragraphs 111 to 118 of this Ruling as those rules may be applicable if interest is prepaid.
- (v) The application fee and stamp duty payable to Arwon Finance and the Application Fee payable to Arrow Funding are borrowing expenses and are deductible under section 25-25. They are incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing expenses arising from finance arrangements other than the finance by Arwon Finance and Arrow Funding is outside the scope of this ruling.

### *Joint Venture Growers*

88. 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 40 of this Ruling and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (ii), (iv) and (v); and
- for the second Joint Venture Grower, fees in relation to the Annual Fee and Rent are set out in paragraphs 43 to 45 of this Ruling and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (iii), (iv) and (v).

**Option 2 – prepayment of Annual Fees and Rent**

89. Where a Post 30 June Grower (who is not a Joint Venture Grower, see paragraph 90 of this Ruling) elects to prepay all Annual Fees and Rent 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>Year ended<br/>30 June 2007</b> | <b>Year ended<br/>30 June 2008</b> | <b>Year ended<br/>30 June 2009</b> |
|-------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>Establishment Fee</b>            | See Notes (i) & (ii)               | Nil                                | Nil                                |
| <b>Prepaid Annual Fees and Rent</b> | Nil                                | Nil                                | See Note (vi)                      |
| <b>Interest</b>                     | Amount incurred<br>See Note (iv)   | Amount incurred<br>See Note (iv)   | Amount incurred<br>See Note (iv)   |
| <b>Borrowing Expenses</b>           | See Note (v)                       | See Note (v)                       | See Note (v)                       |

**Notes:**

- (vi) The prepaid Rent and Annual fees described in paragraph 49 of this Ruling are **NOT** deductible in full in the year incurred. The deduction for each year's fees **must** be determined using the formula in subsection 82KZMF(1) of the ITAA 1936 (see paragraph 117 of this Ruling). This subsection operates to apportion expenditure over the eligible service period or ten years, whichever is the lesser.

*Joint Venture Growers*

90. A Joint Venture Grower may claim the following deductions where the Annual Fees and Rent are pre-paid:

- for the first Joint Venture Grower, fees in relation to the Establishment Services are set out in the Table at paragraph 40 of this Ruling and the deductions available for the fees, interest and borrowing costs (if applicable) are set out in Notes (ii), (iv) and (v); and
- for the second Joint Venture Grower, the fee for the pre-paid Annual Fees and Rent are set out in paragraph 49 of this Ruling and the deductions available for the fee, interest and borrowing costs (if applicable) are set out in Notes (iv), (v) and (vi).

### ***Option 3 – annual deferral of Annual Fees and Rent***

91. 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 –Commissioner’s discretion***

92. A Grower who is an individual and is accepted into the Project during the year ended 30 June 2007 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 30 June 2007 to 30 June 2020. 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**

93. For a Grower who participates in the Project and incurs expenditure as required by the LMA 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.

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## Appendix 1 – Explanation

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❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

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

94. 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.

95. 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.

96. 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.

97. 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.

98. In this Project each Grower enters into a LMA. 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 Sandalwood Lot 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 to the land to carry out its obligations.

99. Under the LMA 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 Sandalwood Lot on the Grower's behalf.
100. The Responsible Entity is also engaged to harvest and sell, on behalf of the Grower, the timber grown on the Grower's Sandalwood Lot.
101. 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.
102. 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.
103. The pooling of timber grown on the Grower's Sandalwood Lot 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 Sandalwood Lot.
104. 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.
105. The Grower's degree of control over the Responsible Entity as evidenced by the LMA, 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 Sandalwood Lot 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.
106. 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***

107. 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.

108. 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 Annual Fees and Rent**

### ***Section 8-1***

109. Consideration of whether the Annual Fees and Rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

110. The Annual Fees and Rent associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the scheme. The fee appears to be reasonable. There is no capital component of the 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***

111. 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.

112. For this Project only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936 are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to STS taxpayers because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

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

113. Other than expenditure deductible under section 82KZMG of the ITAA 1936, if the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (see paragraph 117 of this Ruling) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) of the ITAA 1936 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) of the ITAA 1936).

114. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the scheme 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 scheme 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.

115. For the purpose of these provisions, the scheme includes all activities that relate to the scheme (subsection 82KZME(4) of the ITAA 1936). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier as the financing would be an element of the scheme. The funds borrowed and the interest deduction, are directly related to the activities under the scheme. If a Grower prepays interest under a financing arrangement, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

116. 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) of the ITAA 1936 is relevant. Excluded expenditure is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Growers in this Project, excluded expenditure is prepaid expenditure incurred under the scheme that is less than \$1,000. Such expenditure is immediately deductible.

117. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 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.

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

118. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) 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**

119. Under subsection 82KZMG(1) of the ITAA 1936, 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).

120. Subsection 82KZMG(2) of the ITAA 1936 requires that the expenditure:

- is incurred on or after 2 October 2001 and on or before 30 June 2008;
- 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.

121. To satisfy subsection 82KZMG(3) of the ITAA 1936 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.

122. Under subsection 82KZMG(4) of the ITAA 1936 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.

123. Subsection 82KZMG(5) of the ITAA 1936 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***

124. Under the LMA, a Grower incurs a fee for Establishment Services. This fee consists of expenditure for seasonally dependent agronomic activities. As the requirements of section 82KZMG of the ITAA 1936 have been met, a deduction is allowable in the same income year as the expenditure is incurred under the LMA for seasonally dependent agronomic activities.

***Option 1 – Annual Fees and Rent***

125. Under the LMA each Annual Fee and Rent amount are incurred in the same income year that the services for these fees are provided.

126. On this basis, provided a Grower incurs expenditure as required under the Project scheme, as set out in paragraphs 39 to 48 of this Ruling, then the basic precondition in subsection 82KZME(2) of the ITAA 1936 is not satisfied and in these circumstances, section 82KZMF of the ITAA 1936 will have no application.

***Option 2 – prepayment of Annual Fees and Rent***

127. Growers may elect to prepay Annual Fees and Rent for 12 years after the end of the Establishment Period. For these Growers, the expenditure falls outside the scope of section 82KZMG of the ITAA 1936. Therefore, the Annual Fees and Rent are not deductible in full in the year incurred. The deduction for each year's fees and Rent must be determined using the formula in subsection 82KZMF(1) of the ITAA 1936 (see paragraph 117 of this Ruling).

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

128. Although not required under the LMA for Option 1 above, or for the arrangements with Arwon Finance and Arrow Funding, a Grower participating in the Project may choose to prepay Annual Fees, Rent or interest for a period beyond the expenditure year. Where this occurs, section 82KZMF of the ITAA 1936 will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

129. 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 of the ITAA 1936.

## Interest deductibility

### **Section 8-1**

*(i) Growers who use Arwon Finance or Arrow Funding as the finance provider*

130. Some Growers may finance their participation in the Project through a loan facility with Arwon Finance or Arrow Funding. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Annual Fees and Rent.

131. 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.

*(ii) Growers who DO NOT use Arwon Finance or Arrow Funding as the finance provider*

132. 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 or Arrow Funding is outside the scope of this Ruling. Product Rulings only deal with schemes where all details and documentation have been provided to, and examined by the Tax Office.

133. 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 111 to 118 of this Ruling).

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

134. The Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses, in deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2007 to 30 June 2020**.

135. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2007 up to and including 30 June 2020:

- 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) until a later income year is able to offset that loss against their other assessable income.

136. 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**

137. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

### **Part IVA – general tax avoidance provisions**

138. For Part IVA of the ITAA 1936 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).

139. The Project 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 87 to 90 of this Ruling 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.

140. 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) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

**Appendix 2 – Detailed contents list**

141. The following is a detailed contents list for this Ruling:

|                                                              | <b>Paragraph</b> |
|--------------------------------------------------------------|------------------|
| <b>What this Ruling is about</b>                             | <b>1</b>         |
| Relevant provision(s)                                        | 2                |
| Goods and services tax                                       | 3                |
| Changes in the law                                           | 4                |
| Note to promoters and advisers                               | 6                |
| Class of entities                                            | 7                |
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| <b>Date of effect</b>                                        | <b>12</b>        |
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- commencement of business  
- fee expenses  
- forestry agreement  
- interest expenses  
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- non-commercial losses  
- primary production  
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