

PR 2006/30 - Income tax: FEA Plantations Project 2006 '2007 Growers'

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 March 2006*



Product Ruling

Income tax: FEA Plantations Project 2006 '2007 Growers'

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ⓘ This Ruling 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

1. This Ruling sets out the Commissioner's opinion on the way in which the 'taxation 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 referred to as the 'FEA Plantations Project 2006' or simply as 'the Project'.

Relevant taxation provision(s)

2. The relevant taxation 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 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;
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- sections 82KZME and 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. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of entities

7. The class of entities to whom this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme specified 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 as set out in the description of the scheme. In this Ruling, these entities are referred to as Growers.

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

- entities who intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- entities who participate in the Project through offers made other than through the Product Disclosure Statement;
- entities who are accepted to participate in the Project before 1 July 2006 and after 30 June 2007;
- entities who finance their participation in the Project through loans with Forest Enterprises Australia Limited (FEA) other than those described at paragraphs 50 to 53 of this Product Ruling; and
- FEA Plantations Limited (FEAP) or its associates.

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 at paragraphs 15 to 56.

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

12. This Ruling applies prospectively from 29 March 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

13. 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 scheme covered by the private ruling has not commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the tax law(s) 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 entity's involvement in the scheme.

Scheme

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

- Application for a Product Ruling received on 10 January 2006 as constituted by documents received 19, 23 December 2005 and 10 January 2006 and additional correspondence and emails dated 3, 8, 9, 10, 15, 20 and 21 March 2006;
- Draft Product Disclosure Statement for the FEA Plantations Project 2006 (PDS), issued by FEA Plantations Limited (FEAP) the Responsible Entity, received 19 December 2005;
- Draft **Constitution** establishing the FEA Plantations Project 2006, received on 19 December 2005;
- Draft Compliance Plan for FEA Plantations Project 2006 issued by FEAP, received 19 December 2005;
- Forestry Right Deed between Landowner, FEAP and Forest Enterprises Australia Limited (FEA) (as Grantor), including the land titles form 'transfer creating profit a prendre', received 19 December 2005;
- The **Forestry Right Lease Deed**, (the Lease), to be entered into by each Grower and FEAP (the Lessor), received 19 December 2005;
- Head Management Agreement between FEAP and FEA, received 19 December 2005;
- Draft **Management Agreement**, to be entered into by each Grower and FEAP (the Manager), received 19 December 2005;
- Draft **Loan Agreement** and **Application for Loan Finance**, to be entered into by each Grower seeking finance and FEA, received 19 December 2005;
- The Custodian Agreement between FEAP and the Custodian received 19 December 2005;
- Draft Wood Purchase Agreement between FEAP and FEA, received 19 December 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.

16. The documents highlighted are those that a Grower (referred to in this Ruling as a Grower) may enter into. For the purposes of describing the scheme 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 scheme. The effect of these agreements is summarised as follows.

17. 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

18. The main features of the FEA Plantations Project 2006 are as follows:

Location	Tasmania and areas of New South Wales and Queensland
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Eucalyptus nitens</i> (Shining Gum) and similar species, for the purpose of harvesting and selling timber.
Number of hectares offered for cultivation	Approximately 5,000 with capacity for oversubscription
Size of each interest	0.5 hectares (one Woodlot)
Woodlot Options	<i>Woodlot Option 1</i> - Trees will be planted and maintained for approximately 13 years before being harvested. Growers will receive a thinning return in 2016. <i>Woodlot Option 2</i> - Trees will be planted and maintained for approximately 16 years before being harvested. Growers will receive a thinning return in 2016. It is anticipated the trees will be pruned in approximately years 2, 4 & 6.
Minimum allocation	One Woodlot
Minimum subscription	None
Number of trees per Woodlot	Minimum of 600 trees
Term of the Project	Woodlot Option 1 – 14 years Woodlot Option 2 – 17 years
Initial cost per Woodlot	\$3,465 for Establishment Services

Ongoing costs	Growers will be charged for the cost of any insurance, except for Public Liability insurance
Other costs	Deferred Management Fee and deferred Rent will be a percentage of Harvest Proceeds or from insurance proceeds where the Plantation Crop is damaged or destroyed. The fee will be equal to 15% of the Harvest Proceeds. Pruning fees will be payable for Woodlot Option 2, in year 2 (\$360), year 4 (\$380) & year 6 (\$400), for each Woodlot. These costs will be increased in line with CPI.

19. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. FEA Plantations Limited (FEAP) has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project.

20. Applications to participate in the Project must be made on the application form shown in the PDS. There is no minimum amount that must be raised under the PDS. A Custodian will be appointed under the Custodian Agreement to protect the interests of a Grower in their dealings with FEAP.

21. For an Applicant, who is accepted as a Grower in the Project, FEAP will allocate Woodlots, place their details in a Register and enter into agreements in relation to the Woodlots allocated to the Grower with FEAP and its associates.

22. A Grower accepted on or after 1 July 2006 and on or before 30 June 2007, will commence participation as a '2007 Grower'. **This Ruling only applies in respect of a '2007 Grower' who is accepted into the Project from 1 July 2006 to 30 June 2007. Note that a separate Product Ruling PR 2006/29 has issued for Growers accepted into the Project from 29 March 2006 to 30 June 2006.**

23. The minimum area of Land that can be leased by a Grower under the Project is one Woodlot of 0.5 of a hectare. Plantations in this Project will be established close to other existing plantation holdings that the Forest Enterprises Group has established in Tasmania, northern New South Wales and Queensland. Other regions of Australia with suitable climate, soils and strategic advantages may be included if advice from the Independent Forester approves their inclusion. All plantations for use in this Project will be established on land with well structured soils. All properties chosen are situated:

- in an area with a mild climate and sufficient rainfall throughout the year;

- near major arterial routes and major ports with loading facilities; and
- above low lying flat land prone to flooding.

24. Each Grower will be granted by, and take from the Responsible Entity, a lease of a Forestry Right in a Woodlot under the Forestry Right Lease Deed for the purpose of cultivating and nurturing Trees, and harvesting Timber. The Grower's rights under the Forestry Right Lease Deed will include the right to enter and exclusively use the Woodlot allocated to the Grower including the right to plant, cultivate, manage and harvest Trees on that Land and to sever, take away and sell the Timber.

25. The Grower will also enter into a Management Agreement with FEAP to have suitable Eucalyptus seedlings planted on their Woodlot for the purposes of thinning at approximately 9 years after planting and clear fell at approximately 13 or 16 years after planting, depending on which Woodlot Option is selected. FEAP will establish the Woodlot during the optimal planting season but no later than 12 months after the acceptance of the application.

26. Under the Management Agreement, FEAP will also cultivate the Grower's Trees and be responsible for harvesting, processing and selling the Grower's Timber.

27. The sale proceeds of Timber will be placed in a Proceeds Fund established under the Constitution which will include the proceeds from amounts received at thinning and clear felling of the Timber on the plantation Woodlots from one or both of the Option 1 Proceeds Fund or Option 2 Proceeds Fund. From the relevant Proceeds Fund the Custodian will deduct and pay to FEAP each Grower's respective Rent under the Forestry Right Lease Deed and their Management Fees under the Management Agreement. The amount remaining will be distributed to Growers. Distributions to Growers will be based on the percentage that their Woodlots bear to the total number of Woodlots bears to the total Option 1 Woodlots or Option 2 Woodlots, as the case may be, in the Project.

28. FEAP will endeavour to procure, if requested by the Grower, insurance cover against destruction or damage of the Grower's Woodlot by fire and other usual risks. The Manager will invoice the Grower the relevant insurance premium together with an administration charge of 10% of the amount of the premium in each year or part thereof. Insurance will be compulsory for Growers who obtain finance for their investment from FEA. Growers may elect to arrange their own insurance.

29. Growers will receive an annual report from the Independent Forester and FEAP summarising the progress of plantations in the Project. The report from FEAP will cover:

- compliance with the arrangement as described in the Product Ruling;

- compliance with any changes to the tax laws subsequent to the issue of the Product Ruling and any significant changes to the market which may impact product marketing; and
- any changes to fees.

30. The Project will conclude upon final harvest of the Trees and the sale of the Timber. The thinning of all Woodlots is scheduled to occur about 9 years from planting, where approximately half the Trees will be harvested.

Constitution

31. The Constitution establishes the Project and operates as a deed binding all of the Growers and FEAP. The Constitution sets out the terms and conditions under which FEAP 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.

32. An applicant for an Interest in the Project must complete an application in the form and manner approved by the Responsible Entity. Clause 10 provides that the application must:

- be accompanied by payment of the amount due to, and in the form required by, the Responsible Entity for an Interest in the Project;
- include an irrevocable and binding authority by the applicant to enter into the Forestry Right Lease and Management Agreement, in the form in Schedules 4 and 5 of the Constitution or in such other form and content as the Responsible Entity determines from time to time;
- include a power of attorney in favour of the Responsible Entity; and
- be accompanied by such other information and documents and in such forms as the PDS may require.

33. All moneys received from applications shall be paid to FEAP. FEAP shall, within a reasonable time or at the time of receipt of the Application Money, forward the payment to the Custodian. FEAP must ensure that the Custodian deposits the Application Money into a trust account designated in accordance with section 1017E of the *Corporations Act 2001*. The Application Moneys will be released by the Custodian when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 11).

34. When an applicant becomes a Grower, the Responsible Entity must immediately enter in the Register all relevant details of the Grower and their Land, within 9 months after the issue of an interest in the Project to that Grower. Entry on the Register is conclusive of a Grower's right to an interest in the Project (clause 13).

35. In summary, the Constitution also sets out provisions relating to:

- FEAP powers and duties (clause 3), including the power to delegate and execute documents on FEAP's behalf (clause 3.1);
- termination and winding up of the Project (clause 5);
- the right of FEAP to be paid fees and other expenses (clause 6);
- the Grower's right to request a withdrawal where a Forestry Right Lease cannot be granted within 9 months (clause 11.6);
- the registration of the Forestry Right (clause 12.5);
- the assignment of the Grower's interest in the Project (clause 14);
- proceeds of harvest and distributions (clause 18 and 19);
- insurance proceeds (clause 20); and
- default by Growers (clause 21).

Compliance Plan

36. As required by the Corporations Act, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interest of a Grower is protected.

Forestry Right Deed

37. The Landowner grants to FEAP the Forestry Rights described in clause 6 for the Term commencing on the Commencement Date and ending on the Termination Date. FEAP will register a Forestry Right by lodging an Instrument Form detailing the particulars of the Forestry Right (in Tasmania), a Registration of profit a prendre (in Queensland) or a Transfer Creating Profit a Prendre or Forestry Right (in New South Wales), and lodge a caveat or other document with the Land Titles Office.

Forestry Right Lease Deed

38. The Responsible Entity grants to the Grower a Forestry Right over the Land on which the Grower's plantation will be established including the right for the Authorised User to have the use and benefit of the Forestry Right as it pertains to the Land and includes the right granted in clause 2.1(a)(i) to (iii).

39. Under this Lease the Grower agrees to pay to the Lessor the Rent for the lease of the specified area of Land for the term of the lease period. The term of the Lease is from the date of the allocation of the Land by FEAP, until the clear fell of Trees on the Land.

40. In summary, the Lease also sets out provisions relating to:

- Grower's covenants (clause 3);
- mutual covenants (clause 4);
- payment of Rent (clause 5);
- events of damage or destruction (clause 7); and
- termination (clause 10).

Management Agreement

41. Under the Management Agreement, each Grower contracts with the Manager to establish and maintain a plantation of Trees on their leased area of Land until maturity. At maturity, the Trees will be harvested and the Timber sold on behalf of the Grower.

42. The Manager will provide the Plantation Establishment Services described in clause 1 of the agreement. These include:

- the completion of all preparatory work necessary for the planting of seedlings on the Woodlot including all ploughing and vermin control deemed necessary by the Manager;
- the supply and planting of healthy seedlings to an average density per hectare appropriate to the soil and climatic circumstances of the Woodlot; and
- the control of weeds and other vegetation which might inhibit the growth of the seedlings on the Woodlot.

43. The Plantation Establishment Services shall commence as soon as practical after the date of execution of the Management Agreement being the date on which the Grower's application is accepted ('Agreement Commencement Date'). The Manager will use its best endeavours to complete all Plantation Establishment Services within the first 12 months from the date that the Grower is accepted into the Project.

44. The Manager will provide Management Services related to the tending and rearing of the seedlings and the management and maintenance of the plantation established on the Woodlot (clause 3). These include:

- the replanting to 90% of the average initial planting density, of any seedlings which die during the first year after planting, where such death is caused by planting technique or vermin destruction;

- pruning services in accordance with the following:
 - the trees subject to Woodlot Option 1 will not be pruned; and
 - the trees subject to Woodlot Option 2 will be pruned 3 times before such trees reach approximately 6 years of age;
- the general maintenance of the plantation, fire breaks, and access roads;
- the application of fertiliser to maintain satisfactory growth;
- the provision of an annual written report; and
- the provision of advice and assistance to the Grower generally.

45. In the event that a Grower's plantation suffers damage and it is not economic to nurture the plantation to harvest, the Management Agreement will come to an end as at the date of destruction. The only obligation remaining on the parties will be the obligation of the Grower under the Constitution to pay Deferred Fees (which includes the Management Fees). The Deferred Fees will crystallise on the date of destruction and thereupon become due and payable (clause 15).

46. On behalf of the Grower the Manager will determine the appropriate time for the thinning and clear fell of the Grower's Trees and will market and sell the Grower's Timber.

Draft Wood Purchase Agreement

47. The Manager has entered into a Wood Purchase Agreement with FEA whereby FEA has agreed to purchase the harvested wood for the purchase price, which is fair and reasonable having regard to the market prices at the time of harvest for wood of similar quality and quantity.

Pooling of amounts and distribution of Proceeds

48. Both the Constitution (clause 18, 19 and 20) and the Management Agreement (clause 6) set out provisions relating to the pooling of amounts from the sale of the Grower's Timber and the distribution of Proceeds Funds from that sale or from Insurance Proceeds. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only a Grower who has contributed to the pool making up the Proceeds Fund is entitled to benefit from distribution from those proceeds; and
- any pool of Trees must consist only of Trees contributed by a Grower in the FEA Plantations Project 2006.

Fees

49. The following fees, per Woodlot, are set out in the Management Agreement and Forestry Right Lease Deed:

- \$3,465, for the Plantation Establishment Services to be provided within 12 months of the Grower's application being accepted payable on application;
- Rent of 12% of the Harvest Proceeds;
- a Management Fee of 3% of the Harvest Proceeds; and
- Pruning fees will be payable for Woodlot Option 2, in year 2 (\$360), year 4 (\$380) & year 6 (\$400), for each Woodlot. These costs will be increased in line with CPI.

Finance

50. A Grower can fund their involvement in the Project by borrowing from independent sources or from FEA, a lender associated with the Responsible Entity.

51. Growers are able to borrow from FEA an amount equal to their full application fee less any deposit that applies to the finance option selected. FEA will only provide loan funds to Growers if FEA has sufficient funds available to advance the loan monies for the Growers.

52. FEA provides the loan on a full recourse basis and recovery action will be taken in respect of any default by the borrower. Overdue repayments will incur interest at the default rate of 15% per annum. Standard terms contained in the Loan Agreement and Application for Loan Finance is as follows:

One year interest free

- deposit optional; and
- principal repayable in 12 monthly instalments.

3 years principal & interest

- minimum 10% deposit required;
- fixed interest rate of 9.50%; and
- principal and interest repayable in 36 monthly instalments.

5 years principal & interest

- minimum 10% deposit required;
- fixed interest rate of 10.00%; and
- principal and interest repayable in 60 monthly instalments.

7 years principal & interest

- minimum 10% deposit required;
- fixed interest rate of 10.50%; and
- principal and interest repayable in 84 monthly instalments.

10 years principal & interest

- minimum 10% deposit required;
- minimum application – 10 Woodlots;
- fixed interest rate of 11.00%; and
- principal and interest repayable in 120 monthly instalments.

53. The security for the loan is provided by the assignment to FEA, over the term of the loan, of the Grower's rights and interest in the Management Agreement and the trees planted under it, and every other document, interest or right held in connection with the cultivation of the trees including the Lease Agreement.

54. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with the FEA that materially differs from that set out in the Application for Loan Finance and Loan Agreement provided to the Tax Office by FEAP with the application for this Product Ruling.

55. A Growers cannot rely on any part of this Ruling if the Application Money, is not paid in full on or before 30 June 2007 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted by FEAP, and that application is subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to FEAP by the relevant lending institution on or before 30 June 2007.

56. 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 or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;

- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than FEA, are involved or become involved in the provision of finance to a Grower for the Project.

Ruling

Application of this Ruling

57. Subject to paragraph 8, this Ruling applies only to a Grower who is accepted to participate in the Project and who has executed a Management Agreement on or after 1 July 2006 and on or before 30 June 2007.

58. 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.

The Simplified Tax System (STS)

Division 328

59. 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 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*.

60. 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***

61. 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***

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

Deductions for Establishment Fee, Pruning Fee, interest and stamp duty costs***Section 8-1 and section 25-25***

63. A Grower who is accepted to participate in the Project on or after 1 July 2006 and on or before 30 June 2007 may claim deductions, on a per Woodlot basis, for the following expenditure set out in the Table below.

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Establishment Fee	\$3,465 See Notes (i) & (ii)	Nil	Nil
Pruning Fee (for Woodlot Option 2)	As incurred See Notes (i) & (iii)	As incurred See Notes (i) & (iii)	As incurred See Notes (i) & (iii)
Interest on loans with FEA under the Loan Agreements	As incurred See Notes (iv) & (v)	As incurred See Notes (iv) & (v)	As incurred See Notes (iv) & (v)
Stamp duty payable to FEA under Loan Agreement	Must be calculated See Note (vi)	Must be calculated See Note (vi)	Must be calculated See Note (vi)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted for GST.
- (ii) Under section 82KZMG of the ITAA 1936 the fee for establishment services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 90 to 92) and is deductible in the income year in which it is incurred.
- (iii) The Pruning Fees paid under Planting Option 2 as shown in the Management Agreement are deductible in full in the year that they are incurred. This Ruling does not apply to Growers who choose to prepay the Pruning Fees. Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME to 82KZMF of the ITAA 1936. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (iv) Growers who enter into a Loan Agreement with FEA will incur interest monthly, as set out in the Agreements. Such interest is deductible in the income year in which it is incurred. This Ruling does not apply to Growers who choose to prepay interest under a Loan Agreement with FEA. Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME to 82KZMF of the ITAA 1936. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than FEA is outside the scope of this Ruling. Growers who borrow from lenders other than FEA may request a private ruling on the deductibility of the interest incurred.
- (vi) The stamp duty payable to FEA under the Loan Agreements is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than FEA is outside the scope of this Ruling.

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

Section 35-55 – exercise of Commissioner’s discretion

64. A Grower who is an individual accepted into the Project on or after 1 July 2006 and on or before 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 a Grower for Growers who participate under one or both of the Planting Options:

- Planting Option 1 for the income years ending 30 June 2007 to 30 June 2020 or the income year preceding the harvest of the Grower’s Trees (whichever occurs sooner); and/or
- Planting Option 2 for the income years ending 30 June 2007 to 30 June 2023 or the income year preceding the Harvest of the Grower’s Trees (whichever occurs sooner).

65. 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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraph 93);
- 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.

Appendix 1 – Explanation

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?

67. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the FEA Plantations Project 2006 must amount to the carrying on of a business of primary production.

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

69. For schemes such as that of the FEA Plantations 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 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.

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

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

71. In this Project, each Grower enters into a Management Agreement and a Forestry Right Lease Deed.

72. Under the Forestry Right Lease Deed each individual Grower will have rights over a specific and identifiable area of 0.5 hectares of land. The Forestry Right Lease Deed provides the Grower with an ongoing interest in the specific Trees on the leased area for the Term of the Project. Under the Forestry Right Lease Deed the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Forestry Right Lease Deed allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

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

74. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the Timber grown on the Grower's Land.

75. 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.

76. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the 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.

77. The pooling of Timber from Trees grown on the Grower's Land 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 Land.

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

79. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the Term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Land and the activities carried out on the Grower's behalf. A Grower is able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

80. 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 FEA Plantations Project 2006 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

81. 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.

82. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Establishment Fee and Pruning Fees

Section 8-1

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

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

84. The Establishment and Pruning 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 Trees) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the scheme. The fee appears to be reasonable. There is no capital component of the Establishment and Pruning Fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

Section 8-1

(i) A Grower who uses FEA as the finance provider

85. A Grower may finance their participation in the Project through a loan facility with FEA. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Establishment and Pruning Fees.

86. The interest incurred for the year ended 30 June 2007 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – the establishment and maintenance of the Trees – 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) A Grower who does NOT use FEA as the finance provider

87. The deductibility of interest incurred by a Grower who finance their participation in the Project through a loan facility with a bank or financier other than FEA 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.

Prepayment provisions

Sections 82KZL to 82KZMG

88. 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.

89. For the Arrangement that applies to this Product Ruling, only sections 82KZL (an interpretive provision) and 82KZMG of the ITAA 1936 are relevant (but see paragraphs 93 to 95 for comments on the possible application of sections 82KZME and 82KZMF of the ITAA 1936).

Section 82KZMG

90. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure incurred under a plantation forestry managed agreement. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees. Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of its eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936), and by the end of the following income year.

Application of the prepayment provisions to this Project

91. Under the Management Agreement, a Grower incurs an initial Establishment Fee consisting of expenditure of \$3,465 that is for 'seasonally dependent agronomic activities'.

92. As this expenditure meets the requirements of section 82KZMG of the ITAA 1936 a Grower can claim an immediate deduction for the Establishment Fee under the Management Agreement in the income year in which the amount is incurred.

Sections 82KZME and 82KZMF

93. Under the Arrangement to which this Product Ruling applies fees for Rent under the Forestry Right Lease Deed and the Management Fee payable under the Management Agreement are only payable as a percentage of the proceeds from the harvest and sale of the Trees, or from insurance proceeds. Interest payable under each of the finance packages offered by FEA is incurred and payable monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Arrangement.

94. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project chose to prepay interest under a finance agreement with FEA or chose or is required to prepay interest under a loan agreement with a lender other than FEA. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

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

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

Section 35-55 – exercise of Commissioner’s discretion

96. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 64, the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- 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.

97. 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

98. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

99. 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).

100. The FEA Plantations Project 2006 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 63 to 64 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

101. A Grower to whom this Ruling applies intends to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Trees. There are no facts that would suggest that a Grower has the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) 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.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

PR 2006/29; TD 93/34;
TD 2003/12; TR 92/20; TR 97/11;
TR 98/22; TR 2000/8;
TR 2001/14; TR 2002/6;
TR 2002/11

Subject references:

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

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- ITAA 1936 82KZMB
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- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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