

PR 2007/2 - Income tax: Bioforest Sustainable Timber and Biofuel Project 2007



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Product Ruling

Income tax: Bioforest Sustainable Timber and Biofuel Project 2007

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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. 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.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the Bioforest Sustainable Timber and Biofuel Project 2007 or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits.

3. The class of entities who can rely on those tax benefits are referred to as Growers. Growers will be those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and who have executed the relevant Project Agreements set out in paragraph 26 of this Ruling on or before 30 June 2007. They must 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.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling 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;
- are accepted into this Project before the date of this Ruling or after 30 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement; or
- are associates of Bioforest Ltd.

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 26 to 76 of this Ruling.

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

- this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

8. This Product Ruling applies prospectively from 24 January 2007, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 24 January 2007 until 30 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2009.

9. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. 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)).

11. 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.

12. 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).

Changes in the Law

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

14. 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

15. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes 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 Product Ruling is issued.

Goods and Services Tax

16. All fees and expenditure referred to in this Product 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.

Ruling

Application of this Ruling

17. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 26 to 76 of this Ruling.

18. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Land Sourcing and Management Agreement.

The Simplified Tax System (STS)***Division 328***

19. 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 depending on whether the Grower was an 'STS taxpayer' prior to 1 July 2005 and 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*.

20. For these Growers only, 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***

21. 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 and section 17-5***

22. 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.

Deduction for management fees, rent, borrowing expenses and interest***Section 8-1, section 25-25, Division 27 and section 40-880 of the ITAA 1997 and section 82KZMG of the Income Tax Assessment Act 1936***

23. A Grower may claim tax deductions for the following fees and expenses on a per Timberlot basis, as set out in the Table below.

Fee Type	Year ending 30 June 2007	Year ending 30 June 2008	Year ending 30 June 2009
Establishment Services Fee	\$5,500 See Notes (i) & (ii)		
Interest on loans with Nominated Financiers	As incurred See Note (iii)	As incurred See Note (iii)	As incurred See Note (iii)
Loan Establishment Fee	Must be calculated See Note (iv)	Must be calculated See Note (iv)	Must be calculated See Note (iv)
Instalment Agreement Administration Fee	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated 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) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the fee for Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 95 to 97 of this Ruling) and is deductible in the income year in which it is incurred.
- (iii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Allco Managed Investments Limited as Trustee of the Gateway Momentum Trading Trust No. 1 ('Nominated Financier') or United Pacific Finance Pty Ltd, is outside the scope of this Ruling. Prepayments of interest to any lender, including the Nominated Financier or United Pacific Finance Pty Ltd, are also not covered by this Product Ruling. Growers who enter into agreements with other financiers and/or prepay interest may request a private ruling on the deductibility of the interest incurred.

- (iv) The Application Fee payable to the Nominated Financier or the Establishment Fee payable to United Pacific Finance Pty Ltd is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing money that is used or is 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 the Nominated Financier or United Pacific Finance Pty Ltd is outside the scope of this Ruling.
- (v) The Administration Fee payable to Bioforest Ltd in respect of an Instalment Agreement is not deductible in full when it is incurred. Under section 40-880 it is deductible on a straight line basis over five income years (see paragraphs 88 to 89 of this Ruling).

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

Section 35-55 – exercise of Commissioner’s discretion

24. A Grower who is an individual accepted into the Project in 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 Growers for the income years ended **30 June 2007 to 30 June 2022 or the year before clearfell, whichever is the earliest**. 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.

Prepayment provisions and anti-avoidance provisions

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

25. For a Grower who commences participation in the Project and incurs the expenditure set out in the Land Sourcing and Management Agreement and in either a Lease Agreement (NSW)/Forestry Right or a Profit à Prendre (Queensland)/Forestry Right, 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;
- 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.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 27 October 2006 and additional correspondence, including emails, dated 12 December 2006, 16 December 2006, 20 December 2006 21 December 2006, 23 December 2006 and 10 January 2007;
- Draft Product Disclosure Statement for the Bioforest Sustainable Timber and Biofuel Project 2007, received 10 January 2007;
- Draft **Constitution** establishing the Bioforest Sustainable Timber and Biofuel Project 2007, received 23 December 2006;
- Draft Compliance Plan for the Bioforest Sustainable Timber and Biofuel Project 2007, received 16 December 2006;
- Draft **Land Sourcing and Management Agreement** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Grantor and Manager) and the Grower, received 23 December 2006;
- Draft **Lease (New South Wales)** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Grantor and Manager) and the Grower, received 23 December 2006;
- Draft **Profit à Prendre (Queensland)** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Grantor and Manager) and the Grower, received 23 December 2006;
- Draft **Profit à Prendre Forestry Right** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Transferor and Manager) and the Grower, received 23 December 2006;
- Draft **Profit à Prendre Forestry Right for Carbon Benefits** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Transferor and Manager) and the Grower, received 23 December 2006;
- Draft **Loan Agreements** and loan documents including Application Forms, received 20 December 2006; and

- **Instalment Agreement** for the Bioforest Sustainable Timber and Biofuel Project 2007 between BioForest Ltd (as Responsible Entity) and the Grower, received 20 December 2006.

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

27. The documents highlighted (in bold) are those that 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.

28. 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.

29. The main features of the Bioforest Sustainable Timber and Biofuel Project 2007 are as follows:

Location	North East Coast of New South Wales (NSW) and South East Queensland (QLD)
Type of business to be carried on by each Grower	Commercial growing and cultivation of: <ul style="list-style-type: none"> • Silky Oak (<i>Grevillea robusta</i>); and • She-oak (<i>Casuarina cunninghamiana</i>), for the purpose of harvesting and selling the produce.
Number of hectares offered for cultivation	2,000
Size of each interest (Timberlot)	Approximately 0.5 hectares
Minimum allocation per Grower	2 Timberlots
Number of trees to be established per hectare	800 Silky Oak trees and 11,400 She-oak trees
The term of the Project	Approximately 15 years
Initial minimum cost	\$11,000 for 2 Timberlots
Ongoing costs	
Other costs	Rent, Costs of Felling, Costs of Sale, Costs of Processing and Insurance Premiums.

30. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Bioforest Limited has been issued with an Australian Financial Service Licence 297650 and will be the Responsible Entity for the Project.

31. The Project involves establishing, cultivating and harvesting Silky Oak and She-oak plantations and the subsequent sale of the plantations' produce. The Project may also involve processing the Silky Oak produce before its sale. The term of the Project is approximately 15 years.

32. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 2000 hectares, which corresponds to 4000 Timberlots in the Project.

33. An entity that participates in the Project will do so by acquiring an interest in the Project on or before 30 June 2007. Each interest will consist of a minimum of 2 identifiable areas of land, each of 0.5 hectares in size and referred to as a 'Timberlot'. Initial cost is \$5,500 per Timberlot.

34. When a Grower makes an application for Timberlots, the Grower will execute a Power of Attorney enabling BioForest to act on their behalf. This enables BioForest to enter into the Land Sourcing and Management Agreement, the Lease/Forestry Right and/or the Profit à Prendre/Forestry Right on behalf of the Grower.

35. A Grower participating in the Project will enter into a Land Sourcing and Management Agreement with BioForest (as the Grantor). Under the agreement, the Grantor agrees to grant a Lease/Forestry Right or a Profit à Prendre/Forestry Right in respect of a Timberlot to the Grower, within the period of 9 months commencing on the date of execution of the agreement.

36. BioForest is seeking suitable sites for the Project in NSW and QLD. This Product Ruling only applies to land which meets BioForest's site selection criteria. These criteria are as follows:

- minimum land area is 40 hectares (within 1 kilometre radius). It must be reasonably 'regular' in shape and relatively smooth and flat;
- long term rainfall (greater than 20 years records) must be greater than 800 millimetres per annum;
- soils must be free draining to a depth of at least 3 metres (that is, no hard pans that impede drainage). Consideration will be given to soils that have an impeding layer less than 1 metre below surface and where it is considered that the effect of the impediment could be minimised by ripping;
- sites will preferably be where the water table is at least 1 metre from the surface in the wettest period of the year, that is, no waterlogging;

- sites will already be cleared of trees for agricultural use; and
- sites will have a recent history of fertilizer application.

37. After the Lease/Forestry Right or the Profit à Prendre/Forestry Right of the Timberlot has been granted to a Grower, the Land Sourcing and Management Agreement provides that BioForest (as the Manager) will be responsible for establishing and cultivating trees on the Timberlot. The Manager will plant a minimum of 400 Silky Oak and 5,700 She-oak trees on each Timberlot. The Establishment Services must be completed within 12 months of the execution of the Land Sourcing and Management Agreement.

38. Each Grower will use their Timberlots for the purpose of carrying on a business of cultivating and harvesting Silky Oak (*Grevillea robusta*) and She-oak (*Casuarina cunninghamiana*) and the sale of harvested produce.

Constitution

39. The Constitution establishes the Project and operates as a deed binding on all of the Growers and BioForest as the Responsible Entity. The Constitution sets out the terms and conditions under which BioForest agrees to act as the Responsible Entity for the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

40. Under the terms of the Constitution, all moneys received from Growers on application shall be paid to the Responsible Entity. The Responsible Entity shall deposit the moneys into the Application Fund (clauses 3.3 and 5 of the Constitution). The application moneys will be released when the Responsible Entity is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 5, 7 and 8 of the Constitution).

Compliance Plan

41. As required by the *Corporations Act 2001*, Bioforest Ltd has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Bioforest Ltd manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Land Sourcing and Management Agreement

42. A Land Sourcing and Management Agreement (Management Agreement) will be entered into between BioForest (as the Grantor and Manager) and the Grower.

43. Under the Management Agreement, the Manager agrees to determine the location of areas of land or Timberlots that will be used by the Grower to carry on a long term commercial afforestation business. The Timberlots will be located in NSW and/or QLD. After the Timberlots are located and within 9 months of the execution of the Management Agreement, the Grantor will grant to the Grower:

- a Lease/Forestry Right of the Timberlots, for the Timberlots located in NSW; and/or
- a Profit à Prendre/Forestry Right for the Timberlots, located in QLD.

44. Under the Management Agreement the Grower appoints BioForest to manage the Grower's Timberlots. The Manager must provide the 'Establishment Services' and 'Services' as specified in the Management Agreement (clauses 1.1 and 5 of the Management Agreement).

45. The Establishment Services will be completed during the 12 month period commencing from the date of execution of the Management Agreement (the Establishment Period). However, these services will only be conducted after a Lease/Forestry Right and/or a Profit à Prendre/Forestry Right is granted to the Grower for the Timberlots.

46. The Services will be provided from the expiry of the Establishment Period until the end of the Project.

47. The Establishment Services are paid for by the Establishment Services fees and the Services are paid for by Management and Maintenance fee (Item 3 in the Schedule to the Land Sourcing and Management Agreement).

Harvesting and Sale

48. The Grower will appoint the Manager to arrange for the harvest and sale of the Forest Produce grown on the Grower's Timberlots (clauses 7 and 8 of the Management Agreement).

49. The Silky Oak trees are expected to be thinned when they are 10 years of age producing a commercial harvest of small sawlogs. They will be clear-felled at approximately 15 years of age. The She-oak trees, which re-grow after harvest, will be harvested at 2 to 3 yearly intervals until the final harvest at approximately 9 years (a total of 4 harvests).

50. The Manager will use its best endeavours to arrange for the processing of the Silky Oak produce and the sale of all the produce (whether processed or not). In determining whether to process the Silky Oak produce, the Manager will have regard to what is in the best interests of the Growers and consider all other relevant factors (clause 8 of the Management Agreement).

51. The unprocessed produce and, if applicable, the processed produce from each Grower's Timberlots will be pooled with other Growers' produce from the Project and sold by the Manager on behalf of the Growers. However, the produce will not be pooled with produce from the plantations of other growers outside this Project (clause 30 of the Constitution). The Manager will use its best endeavours to negotiate the sale of the produce for the maximum practicable price available, having regard to relevant factors such as marketable volumes, terms of contract and stability of purchaser (clause 8 of the Management Agreement).

52. The Growers' proceeds from the sale of the produce will be paid into a Proceeds Fund bank account (clause 3.3 of the Constitution). A Grower's Proportional Interest in these proceeds will be distributed to the Grower after deducting the amounts referred to in clause 10 of the Management Agreement. These deductions include:

- the Grower's Proportional Interest of the Costs of Felling, the Costs of Sale and if applicable the Costs of Processing; and
- Rent and Management and Maintenance fees due by the Grower to the Manager.

53. In the event of a partial or total destruction of the Trees on a Grower's Timberlots, and any successful claim made pursuant to a policy of insurance, the Manager will hold the Grower's insurance proceeds in the Proceeds Fund on trust for the Grower. On receipt by the Manager of insurance proceeds, the Manager must determine the Grower's Proportional Interest of the insurance proceeds and as soon as practicable after receipt, the Manager must pay to the Grower any Proportional Interest less any deductions and costs as stipulated under clause 12 of the Lease/Forestry Right/Profit à Prendre Agreement (clause 10(e) of the Management Agreement).

54. In the case of partial destruction of a Grower's Timberlot(s) and the remaining Trees being of sufficient quality and quantity to warrant the Project continuing, the Grower's Proportional Interest in the Forest Produce will be reduced to reflect a smaller number of Trees to be harvested by the Manager on the Grower's behalf (clause 12(i) of the Lease/Forestry Right/Profit à Prendre).

55. If the Manager determines that amounts in the Proceeds Fund are too small to be distributed, the Manager may postpone distribution of those amounts until it determines that a reasonable amount is available for distribution (clause 30.5 of the Constitution).

Lease/Forestry Right and Deed of Profit à Prendre/Forestry Right

56. Where the Manager makes a determination under the Management Agreement that a Grower's Timberlots will be located in NSW, the Manager will execute a Lease/Forestry Right on behalf of the Grower to lease the Timberlots to the Grower. Where the Manager determines that a Grower's Timberlots will be located in QLD, it will execute a Profit à Prendre/Forestry Right on behalf of the Grower. The Manager may also determine that the Grower's Timberlots will be located in both NSW and QLD. In this situation, both a Lease/Forestry Right and a Profit à Prendre/Forestry Right will be executed on behalf of the Grower.

57. To protect the rights of the Growers (as described in paragraph 58 of this Ruling), the Manager will register with the relevant State land authorities the Lease/Forestry Right and/or the Profit à Prendre/Forestry Right held by the Growers during the term of the Project.

58. Both the Lease/Forestry Right and the Profit à Prendre/Forestry Right will give the Grower full right and interest in the produce and the right to have the produce sold (clause 11.3 of both the Lease and Deed of Profit à Prendre and clause 13.3 of the Forestry Right). The Lease/Forestry Right or Profit à Prendre/Forestry Right will terminate on the date that the final distribution of the sale proceeds is made to the Grower or on the date the Project is terminated, pursuant to the terms of the Constitution.

59. Each Grower must pay Rent to the Manager for the leasehold interest and/or the profit à prendre being an amount as specified in the Schedule to the Lease/Forestry Right and the Schedule to the Profit à Prendre.

60. Under both the Lease/Forestry Right and Profit à Prendre/Forestry Right, among other things, the Grower:

- must not use the Timberlots for any purpose other than commercial silviculture;
- must cultivate and work the Timberlots for the purpose of commercial silviculture;
- shall keep the Timberlots reasonably free of noxious weeds, scrub and undergrowth and prevent erosion or degradation of the Timberlots; and
- shall comply will all laws and regulations relating to the use and occupancy of the Grower's Timberlots.

61. The Manager will arrange for insurance that will be paid for by the Grower, to insure against destruction or damage to each Timberlot. In addition, the Grower may take out additional insurance cover for each of the Grower's Timberlots, at the Grower's own expense (clauses 5.4 and 12 of the Lease and Profit à Prendre and clauses 7.4 and 14 of the Forestry Right).

62. If all or substantially all of the Trees on the Grower's Timberlots are destroyed by fire or other cause, the Management Agreement and Lease/Forestry Right/Profit à Prendre/Forestry Right will terminate with effect from the time the event causing the destruction or damage occurs. However, the rights of the Manager and Grower will continue until all amounts required to be paid to the Grower out of the Proceeds Fund have been paid.

Fees

63. The Grower must pay the following amounts to the Manager for each Timberlot:

- **Establishment Services fee** of \$5,500 payable on application (item 3 of the Schedule to the Management Agreement);
- **Management and Maintenance fee** of 11% of Net Proceeds of Sale (Item 3 of the Schedule to the Management Agreement);
- **Rent** of 25% of Gross Proceeds of Sale for any harvests of She-oak and 7% Gross Proceeds of Sale for any harvests of Silky oak (Item 6 of the Schedule to the Lease/Forestry Right/Profit a Prendre);
- **Costs of Felling, Costs of Sale** and if applicable the **Costs of Processing** equal to the Grower's Proportional Interest of these costs. These costs are deducted from the Grower's Gross Proceeds of Sale (clause 10 of the Management Agreement); and
- Annual **Insurance Premiums** that are applicable to the Timberlot are payable when advised by the Manager (clause 5.4 of both the Lease and the Deed of Profit à Prendre and clause 7.4 of the Forestry Right).

64. In the event of total destruction of the Grower's Trees on their Timberlots, where the destruction is caused by an event which is not covered by an insurance policy or against which insurance is not available, the Grower will be required to pay an amount to be determined under the agreements to cover the accrued Management and Maintenance fees and Rent at the time the Timberlots are destroyed.

Finance

65. A Grower who does not pay the Establishment Services fee in full upon application can either:

- borrow from the Nominated Financier;
- borrow from United Pacific Finance Pty Ltd;

- execute an Instalment Agreement with Bioforest Ltd; or
- borrow from an independent lender external to the Project.

66. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with the Nominated Financier or with United Pacific Finance Pty Ltd that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than the Nominated Financier or United Pacific Finance Pty Ltd may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

67. Other than where an Instalment Agreement is in place. Growers cannot rely on any part of this Ruling if the Establishment Services fee 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 subject to finance approval by any lending institution other than the Nominated Financier or United Pacific Finance Pty Ltd, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2007.

Instalment Agreement

68. Where Bioforest Ltd accepts an application from a Grower to pay the Establishment Services fee under a Terms Agreement an administration fee of \$220 plus a deposit of 15% is payable on date of acceptance into the Project with the balance generally payable by 11 equal monthly instalments. The full amount of the Establishment Services fee must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

Finance offered by the Nominated Financier or by United Pacific Finance Pty Ltd

69. Growers can apply to borrow the Establishment Services fee of \$5,500 per Timberlot from the Nominated Financier or from United Pacific Finance Pty Limited, by completing the relevant Finance Application Form. An Establishment Fee of \$250 plus 0.5% of the amount of the loan is payable on application. This fee may be capitalised in the loan.

70. The Nominated Financier will lend on a full-recourse commercial basis under the following arrangements:

- Facility 1 – monthly instalments of principal and interest over 5 years commencing on the first business day of the month following the loan drawdown date.

- Facility 2 – monthly payments of interest only for 2 years plus monthly instalments of principal and interest over 3 years commencing on the first business day of the month following the loan drawdown date.
- Facility 3 – monthly payments of interest only for 3 years plus monthly instalments of principal and interest over 7 years commencing on the first business day of the month following the loan drawdown date.

71. Each of the loans offered by Preferred Financier is subject to a current indicative interest rate of 11.00.% per annum, with the final interest rates to be fixed at the time the loan is drawn down. The maximum amount of finance that can be received by any Grower is \$250,000. An Application Fee of \$250 plus 0.05% of the loan amount is payable by the borrower. The Application Fee will be added to the loan. Interest will accrue on the unpaid balance of the loan and is charged monthly in arrears.

72. United Pacific Finance Pty Limited will lend on a full-recourse commercial basis under the following arrangements:

- Facility 1 – monthly instalments of principal and interest over 5 years commencing one month after loan drawdown date.
- Facility 2 – monthly payments of interest only for 2 years plus monthly instalments of principal and interest over 5 years commencing one month after loan drawdown date.
- Facility 3 – monthly payments of interest only for 3 years plus monthly instalments of principal and interest over 7 years commencing one month after loan drawdown date.

73. All loans are subject to indicative interest rates of 10.45%, based on current interest rates. An Establishment Fee of \$250 plus 0.60% of the loan, to a maximum of \$1,250, is payable by the borrower. The Application Fee may be added to the loan. Interest will accrue on the unpaid balance of the loan and is charged monthly in arrears.

74. The above loans are secured by a registered charge over the Grower's interest in the Project. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

75. This Ruling will not apply to Growers who enter into finance arrangements with the Nominated Financier or with United Pacific Finance Pty Limited, with terms and conditions that differ in any way from those set out in paragraphs 69 to 74 of this Ruling.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL 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 interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than the Nominated Financier or United Pacific Finance Pty Limited are involved or become involved, in the provision of finance to Growers for the Project.

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?

77. For the amounts set out in paragraph 23 of this Ruling to constitute allowable deductions the Grower's afforestation activities as a participant in the Bioforest Sustainable Timber and Biofuel Project 2007 must amount to the carrying on of a business of primary production.

78. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on of a business of primary production.

79. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

80. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Bioforest Sustainable Timber and Biofuel Project 2007. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

81. Having applied these principles to the arrangement set out above, a Grower in the Bioforest Sustainable Timber and Biofuel Project 2007 is accepted to be carrying on a business of growing and harvesting wood produce for sale.

The Simplified Tax System

Division 328

82. 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.

83. Changes to the STS rules apply from 1 July 2005. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (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 the Establishment Services Fee

Section 8-1

84. The Establishment Services Fee is deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Establishment Services Fees (see paragraphs 49 to 51 of TR 2000/8).

85. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Subject to the prepayment provisions (see paragraphs 90 to 94 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred (Note: The meaning of incurred is explained in Taxation Ruling TR 97/7.)

86. Some Growers may finance their participation in the Project through a Loan Agreement with the Nominated Financier or with United Pacific Finance Pty Ltd. Applying the same principles as that used for the Establishment Services Fee, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

87. Other than where the prepayment provisions apply (see paragraphs 90 to 97 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Administration Fee payable under an Instalment Agreement

Section 40-880

88. Growers who elect to pay their Application Fee under the Instalment Agreement must pay an administration fee of \$220. This expenditure does not constitute a borrowing expense and is therefore not deductible under section 25-25. As it is capital in nature it is also not deductible under section 8-1.

89. However, section 40-880 will allow the Administration Fee to be deducted on a straight line basis over five income years. Section 40-880 applies to capital expenditure that is incurred in relation to a business and which is not taken into account elsewhere or denied deductibility under another provision of income tax law.

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

90. 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 income year, then it is not expenditure to which the prepayment rules apply.

91. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and section 82KZMG of the ITAA 1936 (an operative provision). References to sections 82KZME and 82KZMF of the ITAA 1936 are made only in respect their interaction with section 82KZMG and to confirm that these provisions have no application to expenditure incurred by Growers who participate in the scheme set out in this Ruling.

Application of the prepayment provisions to this Project***Sections 82KZME and 82KZMF***

92. Other than the Establishment Services Fee (see below) the fees payable under scheme to which this Product Ruling applies are payable out of harvest proceeds and the interest payable to the Nominated Financier or to United Pacific Finance Pty Ltd is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to expenditure incurred by Growers under this scheme.

93. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays interest under a loan agreement (including loan agreements with lenders other than the Nominated Financier or United Pacific Finance Pty Ltd). Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion in section 82KZME that excludes them from the operation of section 82KZMF.

94. As noted in the Ruling part above, Growers who 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.

Section 82KZMG

95. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules in sections 82KZME and 82KZMF of the ITAA 1936 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 commencement of its eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936), and by the end of the following income year.

96. Under the Land Sourcing and Management Agreement each Grower incurs an Establishment Services Fee of \$5,500 per Timberlot for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the trees.

97. The expenditure for 'seasonally dependent agronomic activities' meets all other requirements of section 82KZMG of the ITAA 1936 and, therefore, a deduction is allowable in the income year ended 30 June 2007 for the full amount of expenditure incurred by the Grower for the Establishment Services Fee.

Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion

98. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2007 to 30 June 2022 or the year before clearfell, whichever is the earliest**, the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years:

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

99. 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.

100. 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

101. 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 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

102. 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).

103. The Bioforest Sustainable Timber and Biofuel Project 2007 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 23 of this Ruling 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.

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

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8, TR 2001/14;
TR 2002/6; TR 2002/11;
TD 2003/12

Subject references:

- carrying on a business
- commencement of business
- management fee expenses
- non-commercial losses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- taxation administration

Legislative references:

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
- ITAA 1997 Div 27
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- ITAA 1997 35-10

- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 40-880
- ITAA 1997 Subdiv 61-J
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- ITAA 1997 Subdiv 328-F
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- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
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- ITAA 1936 82KZME
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- ITAA 1936 Pt IVA
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- ITAA 1936 177D
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- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

ATO references

NO: 2006/25428

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ timber