



PR 2008/70 - Income tax: Kiri Park Projects - 2009 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 May 2008*



Product Ruling

Income tax: Kiri Park Projects – 2009 Growers

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! This publication provides you with the following level of protection:

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

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

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

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

No guarantee of commercial success

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 or the entities that 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 provisions identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Product Ruling this scheme is referred to as the scheme, the 'Kiri Park Projects – 2009 Growers', or simply as 'the Project'.
2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Ruling capitalised terms are specifically defined in the Project agreements.

Class of entities

3. This part of the Product Ruling specifies which entities:
 - are subject to the taxation obligations; and
 - can rely on the taxation benefits;set out in the Ruling section of this Product Ruling.
4. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to in this Product Ruling as 'Growers'.
5. Growers are those entities that:
 - meet the definition of 'initial participant' in subsection 394-15(5); and
 - are accepted to take part in the scheme specified below on or after 22 October 2008.
6. A Grower will have executed the relevant Project agreements set out in paragraph 46 of this Ruling on or before 30 June 2009 and will hold a 'forestry interest' in the Project.
7. The class of entities who can rely on this Product Ruling does **not** include Growers:
 - who are accepted into this Project before 22 October 2008 or after 30 June 2009;
 - who participate in the scheme through offers made other than through the Product Disclosure Statement;
 - whose Project Subscription Moneys, including all loan moneys, are not paid in full to Environmental Forest Farms Management Ltd (Responsible Entity) by 30 June 2009;

- enter into finance arrangements with the Forestry Finance Ltd or United Pacific Finance Pty Ltd other than those specified in paragraphs 83 to 91 of this Ruling; or
- Growers who elect to collect and market their own produce.

Qualifications

8. 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 46 to 92 of this Ruling.

9. 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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Superannuation Industry (Supervision) Act 1993

11. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Date of effect

12. This Product Ruling applies prospectively from 22 October 2008, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 22 October 2008 until 30 June 2009, 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 all income years up to the income year in which the scheme is terminated in accordance with the Project agreements.

13. 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.

14. 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)).

15. 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.

16. 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

17. 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.

18. 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

19. 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

20. 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 any creditable acquisition that it makes it must be registered or required to be registered for GST and hold a valid tax invoice.

21. [Omitted.]

Ruling**Structure of the Project**

22. The Project is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of Paulownia Trees for felling in Australia.

23. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for an 'initial participant'¹ in the defined class of entities (see paragraphs 4 to 7 of this Ruling) who is accepted to participate in the forestry managed investment scheme described below at paragraphs 46 to 92 of this Ruling on or after 22 October 2008 and on or before 30 June 2009.

24. An entity that takes part in the Project as a 'subsequent participant'² is not covered by this Product Ruling but may request a private ruling on their participation in the Project. A subsequent participant is an entity that does not meet the definition of initial participant in subsection 394-15(5).

Carrying on a business

24A. Although not relevant for the purposes of Division 394, a Grower (as described in paragraphs 4 to 6 of this Ruling) who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Such Growers who are individuals will be subject to the operation of Division 35 (see paragraphs 44A and 44B of this Ruling).

¹ See subsection 394-15(5).

² See section 394-30.

The '70% DFE rule' and the establishment of the Trees

25. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by the Responsible Entity, (referred to as the 'forestry manager' in Division 394). On the basis of that information the Commissioner has decided that on 30 June 2009 it will be reasonable to expect that the '70% DFE rule'³ will be satisfied. The Tax Office may undertake review activities during the term of the Project to verify the information relied on for the purposes of the '70% DFE rule'.

26. The Ruling will only apply if the Responsible Entity establishes all of the Trees that were intended to be established under the Project within 18 months of the end of the income year in which the first 'participant' in the Project is accepted.⁴ For this Project the Trees must be established before 31 December 2010.

27. In the context of this Project the Trees will be established when they are planted on the land acquired for the purposes of the Project at the average rate of 555 Trees per hectare. The Responsible Entity is required by section 394-10 of Schedule 1 of the TAA to notify the Tax Office if the Trees are not established by 31 December 2010.

Allowable deductions**Sections 8-5, 394-10 and 394-20**

28. A Grower in the Project can claim, on a per Woodlot basis, deductions for the amounts shown in the table below that are paid to the Responsible Entity (sections 8-5 and 394-10).

29. [Omitted.]

30. The deductibility of these amounts remains subject to a requirement that a CGT event⁵ does not happen in relation to the Grower's 'forestry interest' before 1 July 2013.

31. The amount is deductible in the income year in which it is paid, or is paid on behalf of the Grower (subsection 394-10(2) and section 394-20). Where a Grower does not fully pay an amount, or it is not fully paid on their behalf in an income year, it is deductible only to the extent to which it has been paid. Any unpaid amount is then deductible in the year or years in which it is actually paid.

Fee	Amount	Income year(s) deductible
Project Subscription Moneys	\$6,800 See Note (i)	2008-09

³ The '70% DFE rule' is set out in section 394-35.

⁴ See subsection 394-10(4)

⁵ Defined in section 995-1.

Management Fees	\$685.30 per annum See Note (i)	2009-10 and 2010-11
Management Fees	\$706.20 per annum (indexed from the 2012-13 income year onwards) See Note (i)	All income years from 2011-12 to 2017-18
Rent	\$88 per annum See Note (i)	2009-10 and 2010-11
Rent	\$91.30 per annum (indexed from the 2012-13 income year onwards) See Note (i)	All income years from 2011-12 to 2017-18
Harvesting Costs	Actual costs per annum See Note (i)	All income years from 2015-16 to 2018-19
Harvest Marketing Costs	5.5% of the Gross Sale Proceeds per annum See Note (i)	All income years from 2015-16 to 2018-19

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of the outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.

'CGT event' within 4 years for Growers who are 'initial participants'***Subsections 394-10(5) and (6)***

32. Deductions for the Project Subscription Moneys, the Management Fees and the Rent are not allowable where a 'CGT event' happens in relation to the forestry interest of a Grower before 1 July 2013 (subsection 394-10(5)).

33. Where deductions for these amounts have already been claimed by a Grower the Commissioner may amend their assessment at any time within two years of the CGT event happening (subsection 394-10(6) of the ITAA 1997). The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936.

34. Growers whose deductions are disallowed because of subsection 394-10(5) are still required to include in assessable income the market value of the forestry interest at the time of the CGT event or the decrease in the market value of the forestry interest as a result of the CGT event.

Interest on loans to finance the forestry interest of a Grower, Insurance Premiums and processing costs**Section 8-1**

35. A Grower in the Project can claim deductions for interest incurred on a loan to fund their investment in the Project (paragraph 8-1(1)(a)). This Ruling only applies to loans between a Grower and Forestry Finance Ltd or United Pacific Finance Pty Ltd (United). Growers who borrow from other financiers may apply for a private ruling on the deductibility of loan interest or may self assess the deductibility of the interest.

36. Insurance fees incurred by a Grower to insure their Leased Area (including the Trees and Forest Produce), will be deductible under section 8-1. The deduction is allowable in the year in which the insurance fee is incurred. The Responsible Entity will advise the Grower each year of the amount of the insurance fee.

37. Processing costs incurred by the Grower, to prepare the Grower's Forest Produce for sale and delivery of that Forest Produce, will be deductible under section 8-1. The deduction is allowable in the year in which the processing cost is incurred. The Responsible Entity will advise the Grower each year of the amount of the processing cost.

Borrowing costs**Section 25-25**

38. The loan Application Fee of \$300 payable to Forestry Finance Ltd and the loan Establishment Fee of \$295 (plus 1% of the loan amount) payable to United, are borrowing expenses and are deductible under section 25-25.

39. The deduction for the borrowing expense must be calculated. The amount deductible will depend on the term of the loan.

Loan Term	Amount	Year(s) deductible
12 months	Must be calculated	See Note (ii)
5, 7 or 8 years	Must be calculated	See Note (iii)

Notes:

- (ii) For loan terms of 12 months, the deduction for the borrowing expense is spread over the period of the loan on a straight line basis from the date the loan begins.
- (iii) For loan terms of 5, 7 or 8 years, the deduction for the borrowing expense is spread over 5 years on a straight line basis from the date the loan begins.

40. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Forestry Finance Ltd or United is outside the scope of this Ruling.

Assessable income, CGT events and the forestry interests of Growers who are initial participants

Sections 6-10, 394-25 and 118-20

41. Where a CGT event (other than a CGT event in respect of a thinning⁶ – see paragraph 44 of this Ruling) happens to a forestry interest held by a Grower in this Project the market value of the forestry interest, or the decrease in the market value of the forestry interest, is included in the assessable income of the Grower (sections 6-10 and 394-25).

42. The relevant amount is included in the Grower's assessable income in the income year in which the CGT event happens (subsection 394-25(2)).

43. CGT events for these purposes include those relating to:

- a **clear-fell harvest of all or part of the Trees** grown under the Project;
- the **sale, or any other disposal** of all or part of the forestry interest held by the Grower; or
- any other CGT event that results in a reduction of the market value of the forestry interest held by the Grower.

Amounts received by Growers where the Project Trees are thinned

Section 6-5

44. An amount received by a Grower in respect of a thinning of the Trees grown in this Project is not received as a result of a CGT event and is not otherwise assessable under Division 394. The amount is a distribution of ordinary income that arises as an incident of a Grower holding a forestry interest in the Project. Growers include amounts received for thinning the Trees in their assessable income in the income year in which the amounts are derived (section 6-5).

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

Section 35-55 – exercise of Commissioner's discretion

44A A Grower who will stay in the Project until its completion will be considered to be carrying on a business of primary production. Such a Grower, who is an individual, and accepted into the Project in the year ended 30 June 2009, may make losses from the Project that

⁶ A thinning of the trees includes a selective harvest of immature trees to facilitate better outcomes at harvest. A thinning differs from a clear fell of a percentage of mature trees which may occur over two or more income years.

may be affected by the loss deferral rule in section 35-10 in Division 35. Division 35 does not apply however, to Growers who do not carry on a business.

44B. The discretion in paragraph 35-55(1)(b) will be exercised for a Grower to whom the loss deferral rule would otherwise apply, for the income years ended 30 June 2009 to 30 June 2014. Exercise of the discretion in this case however is conditional on the Project being carried out in the manner described in paragraphs 46 to 92 of this Ruling, but will allow Growers referred to who make losses, to offset them against their other assessable income in the income years in which those losses arise.

Prepayment and anti-avoidance provisions

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

45. Where a Grower is accepted to participate in the Project set out at paragraphs 46 to 92 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- interest paid by a Grower to either Forestry Finance Ltd or United does not fall within the scope of sections 82KZM, 82KZME and 82KZMF of the ITAA 1936;
- section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA of the ITAA 1936 will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 10 January 2008, 21 April 2008, 28 May 2008, 10 June 2008, 12 June 2008, 27 June 2008, 30 June 2008, 15 July 2008, 16 July 2008, 17 July 2008, 18 July 2008, 6 August 2008, 7 August 2008, 11 August 2008, 12 August 2008, 14 August 2008, 1 September 2008, 3 September 2008, 8 September 2008 and 26 September 2008;
- Draft Product Disclosure Statement (PDS) for the 'Kiri Park Projects – 2009 Growers' project issued by Environmental Forest Farms Management Ltd (Responsible Entity), received 3 September 2008;

- Head Lease between Powton Land Holdings Ltd (Lessor) and the Responsible Entity, received 10 January 2008;
- Draft **Lease and Management Agreement** between the Responsible Entity and the Grower, received 3 September 2008;
- Draft **Constitution** for the Kiri Park Projects, received 7 August 2008;
- Draft Constitution Deed of Variation for the Kiri Park Projects, received 7 August 2008;
- Draft Compliance Plan for the Kiri Parks Projects, received 7 August 2008;
- Independent Foresters report for the Kiri Park Projects, dated 13 November 2007;
- Finance Package for Forestry Finance Ltd including **Loan Agreement** and Application Form, received 14 August 2008; and
- Finance Package for United Pacific Finance Pty Ltd (United) including Finance Application and '**Term Loan Finance – Agreement**' received 10 June 2008 and 12 June 2008.

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

47. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

48. The documents highlighted 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.

Overview

49. The main features of the Project are as follows:

Location	Regan's Ford, Shire of Gingin, Western Australia
Species of Trees to be planted under the scheme	<i>Paulownia fortunei</i> (Paulownia) Trees
Term of the Project	Approximately 10 years
Date all Trees are due to be planted on scheme land	31 December 2010

Number of Trees per hectare	555
Number of hectares offered for cultivation	Approximately 50 hectares
Size of each 'forestry interest'	0.108 hectares
Minimum allocation of 'forestry interests' per Grower	One forestry interest (Woodlot)
Minimum subscription	Nil
Initial cost	\$6,800 per Woodlot
Ongoing costs and other costs	Annual Management Fees and Rent Annual Insurance Harvesting and Processing Costs Harvest Marketing Costs Incentive Fee

50. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Environmental Forest Farms Management Ltd has been issued with an Australian Financial Service Licence 239635 and will be the Responsible Entity for the Project.

51. The Project involves the cultivation of Paulownia Trees and the harvest and sale of the timber from the Trees.

52. The Project will be conducted on land known as 'Kiri Park', at Lot M1254, Hunter Road, Regan's Ford, in the shire of Gingin, Western Australia (approximately 150 kilometres north of Perth). The land for the Project is owned by Powton Land Holdings Ltd (the 'Lessor').

53. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer pertains to 460 Woodlots of 0.108 hectares each. The term of the Project is 10 years. There is no minimum subscription for the Project.

54. An entity that participates in the Project (a 'Grower') will do so by acquiring an interest in the project on or before 30 June 2009, which will consist of a minimum of one Woodlot.

55. The Woodlots will be planted at the rate of approximately 555 Trees per hectare. Water for the Project is available from developed bores and a large dam on the property. The Responsible Entity holds a licence issued by the Waters and Rivers Commission for 1.7 gegalitres of water per annum.

56. The Responsible Entity will provide or arrange to provide the irrigation system in accordance with silvicultural standards suitable for Paulownia plantations.

57. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to execute, on behalf of the Grower, the Constitution, the Lease and Management Agreement and any other documents required to hold an interest in the Project.

58. This Ruling only applies in respect of '2009 Growers', that is, Growers who enter the Project from 22 October 2008, the date this Product Ruling is made, to 30 June 2009.

Constitution

59. The Constitution establishes the Project, and sets out the terms and conditions under which Environmental Forest Farms Management Ltd agrees to act as Responsible Entity and manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project.

60. In order to acquire an interest in the Project, the Grower must make an application for a Woodlot(s) pursuant to the PDS.

61. Under the terms of the Constitution, Application Moneys will be paid into an Application Fund and the proceeds of the sale of Forest Produce will be paid into a Proceeds Fund.

62. The Application Moneys will be released from the Application Fund and applied towards payment of the fees payable under the Lease and Management Agreement when the Responsible Entity is reasonably satisfied that the criteria specified in clause 14 of the Constitution have been met.

Compliance Plan

63. As required by the *Corporations Act 2001*, 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 interests of Growers are protected.

Lease and Management Agreement

64. Growers participating in the scheme will enter into a Lease and Management Agreement with the Responsible Entity. Growers are granted an interest in the land in the form of a Lease for a period of 10 years to conduct afforestation activities on the land.

65. Under the Lease and Management Agreement each Grower appoints the Responsible Entity to perform the Services and the Responsible Entity accepts the appointment. The Responsible Entity will supervise and manage all silvicultural activity on behalf of the Grower in accordance with good silvicultural practice.

66. Item 8 of the Schedule to the Lease and Management Agreement specifies the Initial Services and On-going Services to be performed by the Responsible Entity.

67. The Initial Services that are to be completed not later than 18 months after the allotment of each Grower's interest, include:

- ploughing, ripping and other soil preparation works for each Woodlot;
- procurement of seedlings;
- tending to seedlings prior to planting;
- planting the Paulownia seedlings on the Leased Area at a rate equivalent to 60 Trees per Woodlot by 31 December 2010;
- applying fertilisers, herbicides and pesticides; and
- reduction and eradication of disease, vermin and other pests.

68. The Ongoing Services include:

- cultivating, tending, pruning, fertilising, replanting, spraying and otherwise caring for the Trees as and when required;
- maintaining and keeping in good repair access laneways within the Leased Area;
- maintaining the Leased Area according to good silvicultural and forestry practices;
- replacing any Trees that fail to establish or that die during the first twelve months of the Project;
- harvesting Trees grown on the Leased Area in Years 7, 8, 9 and 10 and processing the timber in accordance with clause 17 of the Lease and Management Agreement; and
- carrying out any other obligation to be performed by the Responsible Entity pursuant to the terms of any agreement entered into by the Responsible Entity for the sale of the Forest Produce.

69. The Responsible Entity will maintain a public risk insurance policy in respect of the Plantation and arrange for insurance of the Leased Area, including the Trees and Forest Produce, on behalf of all Growers. The insurance premiums in respect of the public risk insurance will be borne by the Responsible Entity, where the insurance premiums in respect of the Trees and Forest Produce will be borne by the Grower (clause 21 of the Lease and Management Agreement).

70. The Responsible Entity must provide to each Grower a report on or before 31 October of each year providing details of services

provided and the status of the Trees on the Woodlot(s) (clause 15 of the Lease and Management Agreement).

71. Under clause 18 of the Lease and Management Agreement, a Grower may on Application, notify the Responsible Entity that the Grower elects to collect and market the Collectable Produce, relating to the Grower's Woodlot(s). This Ruling does not apply to Growers who make such an election.

Pooling of Timber and Grower's Entitlement to Net Proceeds

72. Commercial thinning of Trees is expected to occur from Years 7 to 9. In Year 10, the remaining Trees will be harvested and processed. The Responsible Entity will Harvest and Process, or engage a suitably qualified person to Harvest and Process the percentage of Trees as set out in the PDS, unless the Responsible Entity believes that it would be in the best interests of the Growers to defer the Harvests to a later date.

73. The Responsible Entity is appointed to market and sell the Forest Produce on behalf of the Growers who do not make an election under clause 18 of the Lease and Management Agreement (defined for the purposes of this Ruling as 'Non-Electing Growers') on such terms and conditions as the Responsible Entity considers appropriate.

74. The Responsible Entity must ensure that the Gross Sale Proceeds are deposited into the Proceeds Fund. From the Proceeds Fund the Responsible Entity will pay:

- the Grower's proportional share of Harvesting and Processing Costs;
- the Incentive Fee (if any);
- any Annual Contribution then due and payable by the relevant Grower;
- any other amounts owed to the Responsible Entity by the relevant Grower; and
- 5.5% of the Gross Sale Proceeds for Harvest Marketing Costs.

75. The remaining balance is to be paid to the Grower in accordance with each Grower's Proportional Share.

Fees

76. The Project Subscription Moneys payable to the Responsible Entity on Application is \$6,800 per Woodlot. This amount is represented by:

- fee for land preparation and planting of Trees of \$6,027;

- **Management Fee** of \$685 for services to be provided from the Commencement Date to 30 June 2010; and
- **Rent** of \$88 for the period from Commencement Date to 30 June 2010 (Schedule to the Lease and Management Agreement).

77. The Annual Contribution payable in advance on or before 30 June for the following income year and invoiced to the Grower on 1 June each year consists of the following:

- **Management Fee** of \$685 for the 2010-11 to 2011-12 income years;
- **Management Fee** of \$706.20 for the 2012-13 income year. The Management Fee for the 2013-14 and subsequent years will be the amount payable for the previous year increased at the rate of the consumer price index;
- **Rent** of \$88 for the 2010-11 to 2011-12 income years.
- **Rent** of \$91.30 for the 2012-13 income year. The Rent for the 2013-14 and subsequent income years will be the amount payable for the previous income year increased at the rate of the consumer price index; and
- **Insurance Premiums** for the Leased Area (including the Trees and Forest Produce). The first premium is due in the 2009-10 income year (clause 23.2(c) of the Lease and Management Agreement and item 2.2 of the PDS).

78. From 1 July 2010 onwards, the Responsible Entity may obtain the approval of a Forestry Expert to increase the Annual Contribution if the Responsible Entity estimates that the total actual cost of providing tree farming, including corporate overhead costs, Insurance Premiums and indexation is likely to exceed the amounts set out in the Schedule to the Lease and Management Agreement (clause 23.3 of the Lease and Management Agreement).

79. The Responsible Entity is also entitled to the following amounts that will be deducted from the Gross Sale Proceeds:

- the Grower's Proportional Share of Harvesting and Processing Costs (clause 22.3 of the Lease and Management Agreement);
- an amount equal to 5.5% of the Gross Sale Proceeds for Harvest Marketing Costs (clause 17.3 of the Lease and Management Agreement); and
- an Incentive Fee equal to 27.5% of the amount by which the Net Harvest Return exceeds the Net Harvest Return estimated in the PDS (clause 22.1 of the Lease and Management Agreement).

Finance

80. To finance all or part of the cost of their forestry interest a Grower can enter into a finance arrangement with Forestry Finance Ltd, United or borrow from an independent lender external to the Project.

81. 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 Forestry Finance Ltd or United that materially differs from that set out in the documentation provided 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 United may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

82. A Grower cannot rely on any part of this Ruling if the Project Subscription Moneys are not paid in full on or before 30 June 2009, by the Grower or, on the Grower's behalf, by a lending institution.

Finance offered by Forestry Finance Ltd

83. A Grower choosing to pay the Project Subscription Moneys by entering into a finance arrangement with Forestry Finance Ltd must complete the Finance Application Form in the relevant Finance Package.

84. Growers who enter into a Loan Agreement with Forestry Finance Ltd are required to pay a deposit of at least 10% of the Project Subscription Moneys and a loan Application Fee of \$300 on application.

85. The balance after the 10% deposit is repayable under the following payment options:

- 12 months interest free – 12 monthly payments;
- 5 years principal and interest – 60 monthly payments; or
- 8 years principal and interest – 96 monthly payments.

86. Except for the interest free option, the interest rate is fixed at 12% per annum for loans less than \$5,000 or 12.5% per annum for loans greater than \$5,000 (up to a maximum of \$50,000). The interest payable from the date of application to 30 June 2009 is included in the Principal Sum. Repayments of principal and interest (or principal only in the case of the 12 month interest free option) are made monthly in advance commencing on 1 July 2009.

87. Forestry Finance Ltd will only provide loans to Growers where it has sufficient funds to do so.

Finance offered by United

88. Subject to the terms and conditions of the 'Term Loan Finance – Agreement', a Grower can finance the cost of the Project

Subscription Moneys by borrowing that amount from United under the following arrangements:

- 5 years principal and interest at an interest rate of 11.45%; and
- 2 years interest only followed by 5 years principal and interest at an interest rate of 11.45%.

89. The following conditions apply to the above loan arrangements:

- monthly payments of interest only or monthly repayments of principal and interest payable on the first business day of each month commencing on the first business day of the month following the loan drawdown date;
- Establishment Fee of \$295 plus 1% of the loan amount (may be added to the loan);
- maximum loan size of \$500,000; and
- stamp duty, as applicable.

90. The interest rates mentioned above (in paragraphs 86 and 88 of this Ruling) are only indicative. The actual interest rate for the loans will be set by the lender on the loan drawdown date.

91. The loans from Forestry Finance Ltd and United are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a charge over the Grower's interest(s) in the Project.

92. 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 Forestry Finance Ltd and United, are involved or become involved in the provision of finance to Growers for the Project.

Commissioner of Taxation

22 October 2008

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.*

Structure of the Project

93. In return for payment of the Project Subscription Moneys and the other fees and expenses required under the Project agreements during the term of the Project, Growers will hold a 'forestry interest' in a 'forestry managed investment scheme'. The Project qualifies as a forestry managed investment scheme because its purpose is for 'establishing and tending Trees for felling in Australia' (see subsection 394-15(1)).

94. Under the Lease and Management Agreement of the Project and the other supporting agreements, the holding of a forestry interest in the Project gives each Grower a right to a share in the proceeds of the harvest and share of the proceeds of any thinning of the Trees grown on the Project land. That share of proceeds is determined using the number of forestry interests held by a Grower as a proportion of all forestry interests held by 'participants'⁷ in the Project.

Is the Grower carrying on a business?

94A. The general indicators used by the Courts in determining whether an entity is carrying on a business are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

94B. More recently, and in relation to a managed investment scheme similar to that which is the subject of this Ruling, the Full Federal Court in *Hance v. FC of T*; *Hannebery v. FC of T* [2008] FCAFC 196; 2008 ATC 20-085 applied these principles to conclude that 'Growers' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

94C. Application of these principles to the arrangement set out above leads to the conclusion that a Grower (as described in paragraphs 4 to 6 of this Ruling), who stays in the Project until its completion will be carrying on a business of primary production involving afforestation activities.

Allowable deductions

Sections 8-5, 12-5, 394-10 and 394-20

95. Section 8-5 allows certain specific deductions to be claimed against the assessable income of a taxpayer. The list of specific deductions is shown in a table in section 12-5 and includes payments

⁷ The term 'participant' is defined in subsection 394-15(4).

under a forestry managed investment scheme that meet the requirements of subsection 394-10(1).

The '70% DFE rule'

Paragraph 394-10(1)(c) and section 394-35

96. The threshold test for Growers in the Project to be entitled to deductions under subsection 394-10(1) is the '70% DFE rule' in paragraph 394-10(1)(c). Under that rule it must be reasonable to expect that on 30 June 2009, the amount of 'direct forestry expenditure'⁸ under the scheme will be no less than 70% of the amount of payments under the scheme.⁹

97. The amount of all direct forestry expenditure is the amount of the net present value of all direct forestry expenditure that the Responsible Entity, as 'forestry manager'¹⁰ of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

98. The 'amount of payments under the scheme' is the amount of the net present value of all amounts (that is, the fees and expenses) that all current and future participants in the scheme have paid or will pay under the scheme (subsection 394-35(3)).

99. Both of the above amounts are determined as at 30 June 2009 taking into account:

- the timing requirements in subsections 394-35(4) and (5);
- any amounts that can reasonably be expected to be recouped (subsection 394-35(6));
- the discount rate in subsection 394-35(7); and
- the market value rule in subsection 394-35(8).

100. Applying all of these requirements to the information provided by the Responsible Entity of the Project the Commissioner has determined that the Project will satisfy the 70% DFE rule on 30 June 2009.

The other elements for deductibility under subsection 394-10(1)

101. The requirement of paragraph 394-10(1)(d) that Growers in the Project not have day to day control over the operation of the Project (despite having a right to be consulted or give directions) is clear from the Project agreements. As are the alternative elements of paragraph (e) relating to the number of Growers in the scheme and the Responsible Entity's role in other managed investment schemes.

⁸ See section 394-45.

⁹ See subsection 394-35(1) and section 394-40.

¹⁰ Defined in section 394-15(2).

102. The final requirement for deductibility requires all the Project Trees to be established within 18 months of 30 June 2009 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Ruling by the Responsible Entity indicates that all the Trees required to be established under the scheme will be planted on the Project land by 31 December 2009.

103. Accordingly, subject to the qualifications set out below, amounts paid by Growers to the Responsible Entity in relation their forestry interests satisfy all requirements of subsection 394-10(1). The amounts are allowable deductions in the income year in which they are paid (subsection 394-10(2)).

104. Where a Grower does not fully pay an amount, or the amount is not fully paid on their behalf in an income year (see section 394-20), it is deductible only to the extent to which it has been paid. The unpaid balance is then deductible in the year or years in which it is actually paid. This may occur, for example, if all or part of the amount is borrowed and the financier fails to transfer the funds to the account of the forestry manager on or before 30 June in an income year.

Loss of deductions previously allowed under section 394-10(1)

105. Two situations may lead to a loss of deductions previously allowed to Growers.

106. The first of these situations will occur if the Responsible Entity fails to establish the Trees on the Project land within 18 months. Where this occurs the Responsible Entity is required to notify the Commissioner within 3 months of the end of the 18 month period (section 394-10 of Schedule 1 to the TAA).

107. The second situation where a Grower may have deductions disallowed is where a CGT event happens to their forestry interest within 4 years from 30 June of the income year they paid an amount under the scheme, for example, the Project Subscription Moneys (see subsection 394-10(5)).

108. For the purposes of this provision, the Commissioner is able to amend the assessment of a Grower within 2 years of the relevant CGT event happening. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 394-10(6) of the ITAA 1997).

109. Where a CGT event happens to the forestry interest of a Grower within 4 years, the market value of the forestry interest at the time of the CGT event or the decrease in the market value of the forestry interest as a result of the CGT event is still included in the assessable income of the Grower by section 394-25. The amount must be included in assessable income even where an amendment has disallowed or may disallow the deductions previously allowed under section 394-10.

Interest on loans to finance the forestry interest of a Grower**Section 8-1**

110. Where a Grower borrows money to fund their investment in the Project, the deductibility of the interest incurred on the loan monies falls for consideration under the general deduction provisions of section 8-1. If the interest incurred by the Grower is deductible under the first positive limb in subsection 8-1(1) there is no requirement to consider whether it is also deductible under the second positive limb of that provision. Court decisions show that the same basic test applies to both limbs (see *Ronpibon Tin NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431, at CLR 56; ATD 435).

111. Under the first positive limb of subsection 8-1(1) the interest incurred by a Grower will be deductible if it is incurred in gaining or producing a Grower's assessable income and is not excluded by one of the negative limbs in subsection 8-1(2).

The question of whether an outgoing [is] ... incurred in gaining or producing the assessable income is a question of characterisation (*Fletcher & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613, at CLR 17; ATC 4957; ATR 621).

To the extent that ... outgoings of interest ... can properly be characterised as of a kind referred to in the first limb of [section 8-1] they must draw their character from the use of the borrowed funds (*Fletcher*, at CLR 19; ATC 4958; ATR 623).

[T]he characterisation of interest will generally be ascertained by reference to the objective circumstances of the use to which the borrowed funds are put (*Federal Commissioner of Taxation v. Roberts* (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494, at FCR 257; ATC 4388; ATR 504).

112. Growers in the Project use the borrowed funds to acquire a forestry interest in a forestry managed investment scheme. The holding of that forestry interest will produce assessable income for a Grower in the form of the proceeds of a full or part disposal of the forestry interest or, as a proportionate share of the harvest and thinnings proceeds. The tests of deductibility of interest under the first limb of subsection 8-1(1) are, therefore, met unless one of the exclusions in subsection 8-1(2) apply.

113. For the purposes of this Project, only the capital exclusion in paragraph 8-1(2)(a) is relevant. The use of borrowed funds to purchase a capital asset, such as a forestry interest, does not mean that the interest outgoings are on capital account (see *Steele v. Federal Commissioner of Taxation* (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139, at CLR 470; ATC 4249; ATR 148).

Interest [is a] periodic payment for the use, but not the permanent acquisition of a capital item. Therefore, a consideration of the often-cited three matters identified by Dixon J in *Sun Newspapers Ltd v. FC of T* ... assigns interest ... to revenue (*Australian National Hotels Ltd v. Federal Commissioner of Taxation* (1988) 19 FCR 234;

88 ATC 4627; (1988) 19 ATR 1575, at FCR 241; ATC 4633-4634; ATR 1582).

114. Therefore, the capital exclusion in subsection 8-1(2) does not apply to the interest and, subject only to the potential application of the prepayment provisions, a deduction for the interest can be claimed in the year in which it is incurred (Note: the meaning of 'incurred' is explained in Taxation Ruling TR 97/7).

Prepayment provisions

Sections 82KZL to 82KZMF

115. 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 that will not be wholly done within the same year of income as the year in which the expenditure is incurred. For schemes such as this Project, the main operative provisions are sections 82KZMD and 82KZMF of the ITAA 1936.

116. However, subsection 394-10(7) of the ITAA 1997 specifically provides that sections 82KZMD and 82KZMF of the ITAA 1936 do not affect the timing of amounts deductible under section 394-10 of the ITAA 1997.

117. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with either Forestry Finance Ltd or United will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Ruling applies (see paragraphs 83 to 91 of this Ruling) do not require any prepayment of interest over the term of the loan. Accordingly, the prepayment provisions have no application to Growers who enter into those loans.

118. If a Grower chooses to prepay interest on these loans that Grower may request a private ruling on how the prepayment provisions will affect the timing of their interest deduction.

Borrowing costs

Section 25-25

119. A deduction is allowable for expenditure incurred by a Grower in borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income (subsection 25-25(1)).

120. In this Project, the Application Fee payable to Forestry Finance Ltd and the Establishment Fee payable to United, are incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

121. The deduction for each borrowing expense is spread over the period of the loan or 5 years, whichever is the shorter (subsection 25-25(4)).

Assessable income, CGT events and the forestry interests of Growers who are initial participants

Sections 6-10, 10-5 and 394-25

122. Section 6-10 includes in assessable income amounts that are not ordinary income. These amounts, called statutory income, are listed in the table in section 10-5 and include amounts that are included in the assessable income of initial participants of a forestry managed investment scheme by subsection 394-25(2).

Subsection 394-25(2)

123. Where a CGT event¹¹ (other than for a CGT event in respect of a thinning)¹¹ happens to a forestry interest held by a Grower in this Project, subsection 394-25(2) includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted an amount under section 394-10; or
- the Grower would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 32 to 34 and paragraphs 105 to 109 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to CGT events

124. If, as a result of the CGT event the Grower either:

- no longer holds the forestry interest; or
- otherwise – where the Grower continues to hold the forestry interest, but there is a decrease in the market value of the forestry interest;

then the market value of the forestry interest at the time of the event, or the reduction of the market value of the forestry interest as a result of the event, is included in the assessable income of the Grower in the income year in which the CGT event happens (subsection 394-25(2)). A market value rule applies rather than the amount of money actually received from the CGT event (subsection 394-25(3)). However, the market value and the actual amount of money received may be the same.

¹¹ A thinning under this scheme is not a 'CGT event'.

125. The market value amount included in the assessable income of a Grower is the value of the forestry interest just before the 'CGT event', or where the Grower continues to hold their interest after the event, the amount by which the market value of the forestry interest is reduced as a result of the CGT event (subsection 394-25(2)).

126. Section 394-25 will apply where the forestry interest is sold, is extinguished, or ceases, and will include CGT events such as a full or partial sale of the forestry interest or from a full or partial clear-fell harvest of the Trees grown under the Project.

Section 6-5 – amounts received by Growers where the Project Trees are thinned

127. Section 394-25 specifically excludes from the operation of Division 394 a CGT event that happens in respect of a thinning (see paragraph 394-25(1)(c)).

128. Thinning amounts received by a Grower in this Project do not arise as a result of a CGT event and are not otherwise assessable under Division 394. The receipt of an amount arising from a thinning of the Project Trees is a distribution that arises as an incident of the Grower holding a forestry interest in the Project. It is an item of ordinary income and is assessable under section 6-5 in the year in which it is derived.

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

128A. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ended 30 June 2009 to 30 June 2014 the Commissioner has applied the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner's discretion. 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.

128B. 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.

128C. The exercise of the Commissioners discretion under paragraph 35-55(1)(b) for Growers who will stay in the Project until its

completion is conditional on the Project being carried out 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

129. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient additional benefits will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

130. 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).

131. The Project will be a scheme and a Grower will obtain a tax benefit from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 28 to 40 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.

132. Growers to whom this Ruling applies will derive assessable income from holding or disposing of their forestry interest in the Project. 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 Growers 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 98/22; TR 97/11; TR 2007/6

Subject references:

- 4 year holding period
- 70 per cent DFE rule
- carrying on a business
- DFE
- direct forestry expenditure
- forestry interest
- forestry MIS
- interest expenses
- managed investment schemes
- market value substitution rule
- payments under the scheme
- producing assessable income
- product rulings
- reasonable expectation
- tax avoidance
- taxation administration

Legislative references:

- ITAA 1936
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZLA
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- ITAA 1936 82KZMA
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- ITAA 1936 82KZMC
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- ITAA 1936 82KZME
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- ITAA 1936 Pt IVA
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