


PR 2011/13 - Income tax: Forest Rewards Sandalwood Project 2000 - Revised Arrangement

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Product Ruling

Income tax: Forest Rewards Sandalwood Project 2000 – Revised Arrangement

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives 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.

Participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for 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.
2. In this Product Ruling this scheme is referred to as the Forest Rewards Sandalwood Project 2000 or simply as 'the Project'.

Class of entities

3. 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. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Growers or Participating Growers.
4. The class of entities who can rely on those tax benefits consists of those entities that:
 - were accepted to participate in the Project as specified in PR 2000/30 between 5 April 2000 and 30 June 2000 inclusive; and
 - continue to participate in the Project as a Participating Grower by paying the Upfront Fee (see paragraph 39).

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.

5. 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:
 - have terminated their involvement in the scheme;
 - have their interest terminated as outlined in paragraph 41;
 - intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it; or
 - were accepted into this Project before 5 April 2000 or after 30 June 2000.

Superannuation Industry (Supervision) Act 1993

6. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme 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 scheme may contravene the provisions of SISA.

Qualifications

7. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is in accordance with the scheme described in paragraphs 32 to 51 of this Ruling and paragraphs 13 to 37 of PR 2000/30.

8. 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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3-5 National Circuit
Barton ACT 2600

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

Date of effect

10. This Product Ruling applies from 30 March 2011, the day Black Tree Pty Ltd (Black Tree) was appointed as the Manager of this Project. It applies only to the specified class of entities that entered into the scheme from 5 April 2000 until 30 June 2000, being the period specified in PR 2000/30. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities.

11. However, this Product Ruling only applies to the extent that there is no change in the scheme described in PR 2000/30 or in the entity's involvement in the scheme other than those changes detailed below.

Changes in the law

12. Although this Product Ruling deals with the income tax laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

13. 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

14. 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 Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Goods and Services Tax

15. 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.

Previous Rulings

16. Product Ruling PR 2000/30 was withdrawn on 20 June 2001 as the Project was no longer being marketed. The Notice of Withdrawal is amended on 18 May 2011. PR 2000/30 still applies for Growers in relation to the deductibility of fees and other costs incurred between 5 April 2000 and 30 March 2011, the day Black Tree was appointed as Manager for the Project.

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 entered into the scheme described at paragraphs 32 to 51 of this Ruling and paragraphs 13 to 37 of PR 2000/30.

18. The Grower's ongoing participation in the Project constitutes the carrying on of a business of primary production.

Small business concessions

19. From the 2007-08 income year a range of concessions, previously available under the Simplified Tax System (STS), became available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

20. A small business entity can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Because of these choices and the eligibility conditions the application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Product Ruling.

Assessable income***Sections 6-5***

21. 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.

22. If the reconciliation of the Annual Management Fee (see paragraph 47) results in an amount being returned to the Grower under clause 4.2(f) of the Management Agreement, that amount will be assessable income under section 6-5 in the year received.

Deductions for Upfront Fees, Annual Fees, Performance Fees and Rent***Section 8-1 and Division 27***

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

24. The Upfront Fees, Annual Fees, Performance Fees and Rent in respect of a Grower's existing Woodlots are deductible under section 8-1 in the income year that they are paid.

25. Growers may also take up additional Woodlots. The tax consequence of investing in additional Woodlots is outside the scope of this Ruling.

26. Finance for fees connected with continued participation in the scheme will not be provided by any entity associated with this Project. The deductibility or otherwise of interest is therefore outside the scope of this Ruling.

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

Section 35-55 – annual exercise of Commissioner’s discretion

27. For each of the income years ending 30 June 2011 to 30 June 2019, the Commissioner will exercise the discretion in subsection 35-55(1) once the following conditions are satisfied for the year concerned:

- the Grower carried on their business of forestry during the income year;
- the business activity that is carried on is not materially different to that in the scheme described in this Product Ruling; and
- the Grower has incurred a taxation loss for the income year from carrying on that business activity.

28. If these conditions are met for a given year, the Commissioner will exercise the discretion for that year under:

- paragraph 35-55(1)(b) for a Grower in the Project who satisfies the income requirement (see paragraph 63) in subsection 35-10(2E); and
- paragraph 35-55(1)(c) for a Grower in the Project who does not satisfy the income requirement (see paragraph 62) in subsection 35-10(2E).

29. If the Commissioner determines that the discretion will not be exercised for a particular year, or years, the Grower will be informed of that decision and the reasons. In any year where the discretion is not exercised, losses incurred by a Grower will be subject to the loss deferral rule in section 35-10 and the Grower will not be able to offset the losses from the Project against other assessable income.

30. The issue of this Product Ruling of itself does not constitute the exercise of the Commissioner’s discretion in subsection 35-55(1) for any income year.

Anti-avoidance provisions

Section 82KL and Part IVA of the ITAA 1936

31. For a Grower who continues participation in the Project and incurs expenditure as required by the Sub-lease and Management Agreement and Land Interest Agreement, the following provisions of the ITAA 1936 have application as indicated:

- 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

32. The scheme that is the subject of this Ruling is identified and described in paragraphs 13 to 37 of Product Ruling PR 2000/30 and in the following:

- Application for Product Ruling, received on 19 January 2011 and additional correspondence and emails dated 22 March 2011, 5 April 2011 and 2 May 2011;
- Deed Poll made by Rewards Projects Ltd (Subject to Deed of Company Arrangement) as the Responsible Entity for the Project, received 19 January 2011;
- **Sub-lease** between the Sub-lessor, the Responsible Entity and each Grower, received 19 January 2011;
- Supplementary Deed – Sub-lease for the Forest Rewards Sandalwood Project 2000, dated 30 March 2011;
- **Management Agreement** between each Grower and the Responsible Entity, received 19 January 2011, and
- Notice of Meeting booklet for the Forest Rewards Sandalwood Project 2000 meeting held on 17 December 2010.

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

33. The documents highlighted are those that a Grower has entered 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. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

34. The main features of the Forest Rewards Sandalwood Project 2000 are those that were set out in paragraphs 13 to 37 of PR 2000/30 with changes to those features set out in paragraphs 35 to 51 of this Ruling.

Deed of Company Arrangement

35. The Rewards Group of companies was placed into voluntary administration in May 2010. Black Tree proposed a Deed of Company Arrangement (DOCA) under which various Rewards projects, considered to be commercially viable, would be reconstructed and Black Tree would take over management responsibilities.

36. The DOCA was passed at a meeting of Rewards creditors on 19 October 2010 and, as part of the DOCA, meetings of Growers were held on 17 December 2010 to change the terms of the forestry projects. The Responsible Entity for this project is Rewards Projects Ltd (subject to the DOCA).

37. Under PR 2000/30 the original Responsible Entity for this Project was Forest Rewards Ltd which subsequently changed its company name to Rewards Projects Ltd (RPL) in 2002.

Constitution

38. Under the DOCA a Deed Poll was passed by special resolution of Growers which incorporated amendments to the Scheme Constitution. As a result Growers will be required to pay an Annual Fee to fund the ongoing maintenance for the remainder of the Project (see paragraph 46). The Annual Fee is comprised of the Annual Management Fee plus the Grower's Share of the RE Fee payable under clause 10.1D of the Constitution.

39. In addition, RPL will issue to each Grower an invoice for an Upfront Fee of \$347.60 per Woodlot for administration, maintenance and lease expenses to 30 June 2011 and to cover the costs incurred by the Administrator in the care and maintenance of the Project during the period of administration. Growers who pay the Upfront Fee will be 'Participating Growers'.

40. If a Participating Grower fails to pay the total amount (of Annual Fees and Rent) notified in an Annual Invoice (see paragraph 46) by the date set for payment, the Grower will be charged a Deferred Fee for that year. The Deferred Fee is a loss of entitlement to a portion of future Project revenue and will be deducted from the Grower's Share of the sale proceeds of each harvest in accordance with clause 11.1(f).

41. If the cumulative Deferred Fees charged to a Grower totals 100% or more of the Grower's Share of the sale proceeds, the obligation to pay any future Annual Fees or Rent (see paragraph 45) will cease but the Grower will have no entitlement to income.

Additional Woodlots

42. As stated in paragraph 25 of this Ruling, Growers may elect to take up additional Woodlots that become available as a result of former Growers electing not to participate in the revised arrangement. A portion of the Upfront Fee will be capital in nature and not deductible. However, the amount is unknown as of the date of this Ruling and the tax consequence of investing in additional Woodlots is therefore outside the scope of this Ruling.

Supplementary Deed – Sub-lease

43. The Supplementary Deed confirms that the Sub-lease remains in place but the terms and conditions have been replaced with the provisions set out in the schedule to the Supplementary Deed.

44. Paragraph 23 of PR 2000/30 stated that Growers must pay rent to the Lessor of an amount equal to \$120 per Woodlot per annum (Item 5 of the Schedule to the Sub-lease), indexed annually.

45. Pursuant to Clause 3 of the new Sub-lease, the requirement to pay annual rent is still in place. The rent will be payable in advance for each financial year from 30 June 2011. The rent will be set at \$166 per Woodlot per year, indexed to CPI. However, for the 2010-11 year rent will be prorated to the reduced amount of \$69 (five months).

Management Agreement

46. Under clause 4.2, the Responsible Entity is entitled to an Annual Management Fee which will cover the Growers' share of the Total Management Expenses for each financial year. Each year the Responsible Entity must prepare a budget setting out the management services to be provided that year and will issue an Annual Invoice to each Grower for their proportionate share. The Annual Management Fee has been set at \$328.90 per Woodlot for the year ended 30 June 2011 and amounts will be set in later years depending upon the services required.

47. At the end of each Financial Year the Responsible Entity must carry out a reconciliation of the expenses recovered from the Grower pursuant to clause 4.2(c) and the Annual Management Fee. If the expenses recovered are greater than the Annual Management Fee, the excess must be taken into account by the Responsible Entity in setting the subsequent Annual Management Fee. Where the expenses recovered are less than the Annual Management Fee, a supplementary invoice will be issued to the Grower seeking the shortfall.

48. Clause 4.3 provides that a Grower who fails or refuses to pay an amount notified in an invoice issued pursuant to clause 4.2(c)(1) or a supplementary invoice issued pursuant to clause 4.2(g)(2) within the time specified for payment will be charged a Deferred Fee in accordance with the Constitution instead of the Annual Management Fee for that Financial Year.

49. Clause 4.1 provides for the Responsible Entity to charge a Performance Fee set at 10% of the Grower's share of the sale proceeds of each Harvest, after deducting certain costs. This fee will be passed on to the Manager.

Harvest and Sale

50. The Management Agreement also sets out provisions relating to harvesting and selling the plantation. The Responsible Entity has the exclusive right to harvest the trees which will take place as and when deemed appropriate by the Responsible Entity to produce the best overall result for the Grower.

51. The Responsible Entity will pool and negotiate the sale of all Timber of the plantation collectively and distribute in accordance with the Grower's Share. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements as outlined in clause 7 of the Management Agreement:

- only Growers who have contributed trees are entitled to benefit from distributions of the Grower's Share from the pool; and
- any pooled trees must consist only of Sandalwood trees from the same plantation.

Commissioner of Taxation

18 May 2011

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?

52. For the expenditure set out in paragraphs 24 and 45 to 49 of this Ruling to constitute allowable deductions, the Grower's forestry activities as a participant in the Forest Rewards Sandalwood Project 2000 must amount to the carrying on of a business of primary production.

53. PR 2000/30 ruled that a Grower in the Project is accepted to be carrying on a business of growing Sandalwood trees for harvesting and sale.

Deductions for the Upfront Fee, Annual Fees, Performance Fee and Rent

Section 8-1

Existing Woodlots

54. The Upfront Fee in respect of a Grower's own Woodlots is deductible under section 8-1. A 'non-income producing' purpose is not identifiable in the arrangement and there is no capital component evident in these fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7).

55. The Responsible Entity will send an Annual Invoice to the Grower which will specify amounts payable for Annual Fees and Rent and the due date for payment. If the Grower does not pay the full amount they will be charged a Deferred Fee in lieu of payment. Deductibility of the Annual Fees and Rent is therefore contingent on payment. Growers may therefore claim a deduction for Annual Fees and Rent in the income year these amounts are paid.

56. Performance Fees will be deducted from sale proceeds of each harvest and will therefore be deductible in the year incurred.

Additional Woodlots

57. For Growers who elect to take up additional Woodlots, as subsequent participants in those Woodlots, a percentage of the Upfront Fee in respect of the additional Woodlots will be capital in nature and not deductible. The percentage will be based on the level of Administrator's expenses paid by the Responsible Entity for services incurred prior to the woodlot being transferred to the Grower. As the actual percentage is unknown as of the date of this Ruling, the tax consequences of payments for any additional Woodlots are outside the scope of this Ruling.

Deferral of losses from non-commercial business activities and the Commissioner's discretion

Sections 35-10 and 35-55

58. Based on information provided, a Grower who was accepted into the Project in the year ended 30 June 2000 who continues to carry on a business is expected to incur losses from their participation in the Project which will be subject to Division 35. These losses will be subject to the loss deferral rule in section 35-10 unless an exception applies or, for each income year in which losses are incurred, the Commissioner exercises the discretion in subsection 35-55(1) on 30 June of that specific income year.

59. The exceptions to the loss deferral rule depend upon the circumstances of individual Growers and are outside the scope of this Ruling.

60. The Commissioner will apply the principles set out in Taxation Ruling TR 2007/6 Income tax: non commercial business losses: Commissioner's discretion when exercising the discretion.

61. Where a Grower with income for non-commercial loss purposes of less than \$250,000 (that is, the Grower satisfies the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(b) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the 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 Sandalwood forestry industry, the Grower's business activity will satisfy one of the four tests set out in Division 35 or produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)).

62. Where a Grower with income for non-commercial loss purposes of \$250,000 or more (i.e., the Grower does not satisfy the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(c) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not produce assessable income greater than the deductions attributable to it; and

- there is an objective expectation that within a period that is commercially viable for the Sandalwood forestry industry, the Grower's business activity will produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C).

63. A Grower will satisfy the income requirement in subsection 35-10(2E) where the sum of the following amounts is less than \$250,000:

- taxable income for that year (ignoring any loss arising from participation in the Project or any other business activity);
- total reportable fringe benefits for that year;
- reportable superannuation contributions for that year; and
- total net investment losses for that year.

64. In each individual year where the Commissioner's discretion is exercised, a Grower within either paragraph 61 or paragraph 62 who would otherwise be required to defer a loss arising from their participation in the Project under section 35-10 until a later income year is able to offset that loss against their other assessable income.

Anti-avoidance provisions

Section 82KL

65. 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. Therefore, as stated in paragraph 31 of this ruling and paragraphs 40 and 56 of PR 2000/30, section 82KL does not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

66. 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).

67. The Forest Rewards Sandalwood Project 2000 is a 'scheme'. A Grower will obtain a 'tax benefit' from having entered into the scheme in the form of tax deductions that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme was entered into or carried out with the dominant purpose of obtaining this tax benefit.

68. 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 Sandalwood trees. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There 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.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 2007/6

Previous Rulings/Determinations:

PR 2000/30

Subject references:

- carrying on a business
- non-commercial losses
- primary production
- producing assessable income
- product rulings
- public rulings
- tax benefit under tax avoidance schemes
- tax shelters project
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt IVA
- ITAA 1936 170
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2E)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(1)(c)
- SISA 1993
- TAA 1953
- Copyright Act 1968

ATO references

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