


PR 2011/2 - Income tax: Macquarie Eucalypt Project 2011

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Product Ruling

Income tax: Macquarie Eucalypt Project 2011

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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.

Potential 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 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 its strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Product 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 Macquarie Eucalypt Project 2011, or simply as 'the Project'.
2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Product Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Product Ruling, terms defined in the Project agreements have been capitalised.

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 the date this Product Ruling is made.

6. A Grower will have executed the relevant Project Agreements set out in paragraph 46 of this Ruling on or before 30 June 2011 and will hold a 'forestry interest' in the Project.

7. The class of entities who can rely on this Product Ruling does **not** include:

- entities who are accepted into this Project before the date of this Ruling or after 30 June 2011;
- entities who participate in the scheme through offers made other than through the Product Disclosure Statement or who enter into an undisclosed arrangement with:
 - the promoter or a promoter associate, or

- an independent adviser that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits or harvest returns) in any way; or
- entities whose Application Fees, including all loan moneys, are not paid in full to Macquarie Alternative Assets Limited (MAAML) by 30 June 2011, either by the Grower and/or on the Grower's behalf by a lending institution.

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 82 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 Australian Taxation Office (ATO) 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 19 January 2011, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 19 January 2011 until 30 June 2011, 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.

Changes in the law

14. 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.

15. 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

16. 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 ATO 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

17. 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.

Ruling

Structure of the Project

18. The Macquarie Eucalypt Project 2011 is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of *Eucalyptus globulus* (Tasmanian Blue Gum) and *Eucalyptus nitens* (Shining Gum) trees for felling in Australia.

19. 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 at paragraphs 46 to 82 of this Ruling on or after 19 January 2011 and on or before 30 June 2011.

20. 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

21. 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 and also elect to obtain insurance in respect of their Trees 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 of the ITAA 1997 (see paragraphs 41 to 44 of this Ruling).

Concessions for 'small business entities'³

22. From the 2007-08 income year, a range of concessions previously available under the simplified tax system (STS), will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

23. 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 Ruling.

¹ See subsection 394-15(5).

² See section 394-30.

³ The meaning of 'small business entity' is explained in section 328-110

The '70% DFE rule' and the establishment of the trees***Section 394-35 and subsection 394-10(4)***

24. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by Macquarie Alternative Assets Management Limited (MAAML) (the 'forestry manager' in Division 394). On the basis of that information the Commissioner has decided that on 30 June 2011 it will be reasonable to expect that the '70% DFE rule'⁴ will be satisfied. The ATO may undertake review activities during the term of the Project to verify the information relied on for the purposes of the '70% DFE rule'.

25. The Ruling will only apply if MAAML 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 accepted⁵. For this Project the trees must be established before 31 December 2012.

26. 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 1,000 trees per hectare. MAAML is required by section 394-10 of Schedule 1 of the TAA to notify the ATO if all of the trees are not established by 31 December 2012.

Allowable deductions***Sections 8-5, 394-10, 394-20 and Division 27***

27. A Grower in the Project can claim deductions for the amounts shown in the Table below that are paid to MAAML (sections 8-5 and 394-10).

28. The deductibility of these amounts remains subject to a requirement that a CGT event⁶ does not happen in relation to the Grower's 'forestry interest' within 4 years of the Grower first paying an amount under the scheme (see paragraphs 32 to 34 of this Ruling).

29. 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). This requires cash to flow from the Grower, or from another entity on the Grower's behalf, to MAAML's bank account in the year in which the deduction is claimed. Any form of payment that does not involve the movement of cash into MAAML's bank account will not qualify for a deduction under subsection 394-10(2).

30. 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.

⁴ The '70% DFE rule' is set out in section 394-35.

⁵ See subsection 394-10(4)

⁶ Defined in section 995-1.

31. Amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

Fee	Amount	Year(s) deductible
Application Fee	\$2,585 per Interest That is, \$10,340 for a minimum of 4 Interests.	2011 See Note (i)
Deferred Management Fee	5.5% of Net Sales Proceeds	Any year in which this amount is paid. See Notes (i) & (ii)
Deferred Rent	4.95% of Net Sales Proceeds	Any year in which this amount is paid. See Notes (i) & (ii)
Productivity Performance Fee	16.5% of Net Sales Proceeds in excess of \$4,000 per Interest, where the average yield is greater than 60m ³ per Interest. No Productivity Performance Fee is payable with respect to any Net Sales Proceeds derived separately from the sale of any Residual Timber.	Any year in which this amount is paid. See Notes (i) & (ii)

Note:

- (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) Growers will be notified by MAAML of the years in which these amounts are paid.

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

32. Deductions for the Application Fee are not allowable where a 'CGT event' happens in relation to the 'forestry interest' of a Grower before 1 July 2015 (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)). 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

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 Macquarie Bank Limited (MBL). 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.

Borrowing costs

Section 25-25

36. The Investment Loan Application Fee payable to MBL in respect of a 1 year Investment Loan is a borrowing expense and is deductible under section 25-25. 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. No fee is payable in respect of a 5 year or 7 year Investment Loan. Where the Investment Loan Application Fee is less than \$100, the whole of the borrowing expense is deductible in the year in which it is incurred.

37. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than MBL is outside the scope of this Ruling.

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

Sections 6-10, 17-5, and 394-25

38. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁷ – see paragraph 40 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), less any GST payable on those proceeds (section 17-5).

⁷ 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.

39. 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)).

40. '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.

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

Section 35-55 – annual exercise of Commissioner's discretion during the period beginning with the income year ended 30 June 2011 and concluding with the income year ended 30 June 2021

41. For each of the income years from 2010-2011 to 2020-21, 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 afforestation during the income year; and
- 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.

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

43. 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.

44. 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.

Prepayment provisions and anti-avoidance provisions

Sections 82KZM, 82KZME, 82KZMF, 82KL and Part IVA of the ITAA 1936

45. Where a Grower is accepted to participate in the Project set out at paragraphs 46 to 82 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- interest paid by a Grower to MBL does not fall within the scope of sections 82KZM, 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

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 26 November 2010, 10 December 2010 and 22 December 2010 and additional correspondence received on 22 December 2010 and 11 January 2011;
- Product Disclosure Statement (the **PDS**) prepared by the Applicants in respect of the Project, draft dated 23 November 2010;
- Macquarie Eucalypt Project 2011 Constitution (the **Project Constitution**), draft dated 23 November 2010;
- Macquarie Eucalypt Project Compliance Plan, draft dated 23 November 2010;
- Agreement for Ground Lease, Sub-Lease and Forest Property Agreement 2011 between the Land Trust Manager, MBL and MAAML and the Custodian (the **Agreement for Ground Lease, Sub-Lease and Forest Property Agreement**), draft dated 23 November 2010;

- Form of Lease Agreement 2011 between the Land Trust Manager, MBL and MAAML (the **Lease**), draft dated 23 November 2010, which forms part of the Agreement for Ground Lease, Sub-Lease and Forest Property Agreement;
- Form of Forest Property Agreement 2011 between the Land Trust Manager, MBL and MAAML (the **Forest Property Agreement**), draft dated 23 November 2010, which forms part of the Agreement for Ground Lease, Sub-Lease and Forest Property Agreement;
- Form of Sub-Lease Agreement 2011 between MAAML and the Custodian (the **Sub-Lease**), draft dated 23 November 2010, which forms part of the Agreement for Ground Lease, Sub-Lease and Forest Property Agreement;
- Form of Assignment of Forest Property Agreement 2011 between MAAML and the Custodian (the **Assignment of Forest Property Agreement**), draft dated 23 November 2010, which forms part of the Agreement for the Ground Lease, Sub-Lease and Forestry Property Agreement;
- Charge over assets between MAAML and the Land Trust Manager (**Rental Security Charge**), draft dated 23 November 2010;
- Custody Agreement between MAAML and the Custodian dated 26 March 2003;
- Notice of Addition 2011 between the Land Trust Responsible Entity and the Custodian, draft dated 23 November 2010;
- MFSPL Management Agreement 2011 between MAAML and Macquarie Forestry Services Pty Limited (MFSPL or the Forestry Manager) (the **MFSPL Management Agreement**), draft dated 23 November 2010;
- Midway Management Agreement 2011 between MFSPL, Midway Limited (**Midway**), MAAML and MBL (the **Midway Management Agreement**), draft dated 23 November 2010;
- McEwens Management Agreement 2011 between MFSPL, McEwens Contracting Pty Limited (**McEwens**), MAAML and MBL (the **McEwens Management Agreement**), draft dated 23 November 2010;

- Midway Off-Take Agreement 2011 between the Growers (to be executed by the Tree Project Manager on behalf of Growers), MAAML and Midway (the **Midway Off-Take Agreement**), draft dated 23 November 2010;
- Charge over assets between MFSPL, MAAML and the Custodian (The **Forestry Expenses Charge**), draft dated 23 November 2010;
- Pricing and Payment Schedule 2011 to the Midway Off-Take Agreement, between Midway and MAAML draft dated 23 November 2010;
- Macquarie Forestry Investment 2011 – draft Application Form, received on 22 December 2010;
- Macquarie Forestry Investment 2011 – draft Application for Loan between the Investment Lender and a Grower received 22 December 2010;
- Loan and Security Agreement and Notice of Mortgage between the Investment Lender and a Grower (the **Loan and Security Agreement**), forming part of the PDS, draft dated 23 November 2010; and
- Direct Debit request Service Agreement between the Investment Lender and a Grower (the **Direct Debit Request**), forming part of the PDS, draft dated 23 November 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.

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 Macquarie Eucalypt Project 2011 are as follows:

Location	The land will be located anywhere in Victoria which satisfies MAAML's land selection and evaluation process and is within economic haulage distance of a log processor's mill gate in Victoria, for example, Midway's log processing facilities at the port of Geelong, Victoria.
Species of trees to be planted under the scheme	<i>Eucalypt globulus</i> (Tasmanian Blue Gum) and <i>Eucalyptus nitens</i> (Shining Gum)
Term of the Project	Approximately 11 years and 6 months
Date all trees are due to be planted on scheme land	31 December 2012
Number of trees per hectare	Approximately 1,000
Number of hectares offered for cultivation	5,000 hectares
Size of each 'forestry interest'	0.25 hectares
Minimum allocation of 'forestry interests' per Grower	4
Minimum subscription	No minimum subscription
Initial cost	\$2,585 (GST inclusive) per interest That is, \$10,340 (GST inclusive) for 4 interest minimum
Ongoing costs	Deferred Management Fee of 5.5% and Deferred Rent of 4.95% of Net Sale Proceeds or any Tree Insurance Proceeds
Other costs	Annual Tree Insurance premiums payable by the Growers; and Productivity Performance Fee of 16.5% of Net Sale Proceeds in excess of \$4,000 per Interest where the average yield on the plantation is greater than 60 m ³ per Interest for the Plantation Lots for that region.

50. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. MAAML has been issued with an Australian Financial Service Licence 225758 and will be the Responsible Entity for the Project.

51. The Growers in the Project will participate in the planting, maintenance and sale of varieties of Eucalyptus trees including *Eucalyptus globulus* (Tasmanian Blue Gum) and *Eucalyptus nitens* (Shining Gum) trees (the Trees) to produce woodchips for pulping or logs for sale, unless a higher value use for some or all of the Trees is identified at the time of sale to increase the return earned by the Growers.

52. For these purposes, the Growers will pay fees in consideration for the Responsible Entity (RE) agreeing to:

- (a) Provide management services to the Growers in respect of the Project;
- (b) Procure ongoing access to a plot (Plantation Lots) of suitable land for the Project;
- (c) Arrange for the harvesting of the Growers' Trees;
- (d) Arrange for the sale of the Growers' Trees, including by way of executing Off-Take Agreements on behalf of the Growers for sale of the Growers' timber; and
- (e) Various other incidental services.

53. If it is feasible, the RE intends to enter into arrangements with third parties for the offtake of any residual timber from the Plantation Lots. Residual timber is typically harvest residue such as leaves, tops, limbs and undersized trees generated and left following logging of merchantable timber by other Offtakers who are sourcing wood for uses such as woodchips. Any such sale will increase the results earned by the Growers.

54. The offer will be made to retail Investors. Investors will be invited by way of a PDS to participate in and acquire an interest in the Project. **The PDS for the Project also contains an offer to invest in Units in the Land Trust. This Ruling does not address the tax consequences of an investment in the Land Trust.** The Project is established as a registered Managed Investment Scheme (MIS). Other aspects of setting up the Project as a MIS include:

- (a) MAAML will be the responsible entity of the Project (the RE). MAAML is a wholly owned subsidiary of Macquarie Group Limited. MAAML has obtained an Australian Financial Services Licence that authorises the operation of forestry schemes. Although not detailed in the Constitution, MAAML must retire as responsible entity where required by law. Specifically, Division 2 of Part 5C.2 of the *Corporations Act 2001* (Corporations Act) provides that the Manager may be removed by the passing of an extraordinary resolution;
- (b) the Project will be established under a constitution;
- (c) the Project will have a compliance plan so as to comply with the MIS requirements in the Corporations Act;

- (d) Interests in the scheme have to be offered via a product disclosure statement under Part 7.9 of the Corporations Act;
- (e) Investors in the Project will invest in the Project before MAAML, in its discretion, closes the offer; and
- (f) the Growers will appoint the Project RE to enter into the Project documentation on their behalf.

55. The Project is currently confined to the Geelong and Portland regions.

The agreements comprising the Project are summarised in more detail below.

Project Constitution

56. The Project Constitution, and in particular Schedule 1 of the Constitution, sets out the obligations of the RE to each of the Growers. The Project Constitution includes the following provisions:

- (a) authorising the RE to take action on behalf of Growers and exercise the rights, powers and remedies and observe the obligations which are specifically delegated to the RE (refer to clause 10);
- (b) the term of the Investment will be approximately 11.5 years as the Trees are to be sold on average at 10 years of age, or any such further period as agreed between the parties;
- (c) collection and the payment of the Net Sale Proceeds (as defined in clause 25) to Growers on harvest, expected to be in the financial year ending 30 June 2021;
- (d) MAAML agrees to grants the Custodian a Sublease for the benefit of the Growers allowing each Grower to access and conduct their afforestation business on their Plantation Lots. MAAML also grants the Custodian for the benefit of each Grower certain forestry rights in relation to their Plantation Lots, which include the vesting in the Grower of ownership of the Trees, Carbon Sequestration Rights and Environmental Credits (as defined in clause 25) in respect of the Growers Plantation Lots (refer to clause 1, Schedule 1);

- (e) Clause 25 specifies that each Plantation Lot will be an Area of 0.25 hectare. A Plantation Lot will not be split between two regions. Clause 3.2 provides that Plantation Lots will be allocated in the order in which Interests are allocated to Growers but that the RE has discretion as to where Plantation Lots are located and different Plantation Lots may be located in different Regions for different Growers. It is intended that Growers will be given a sequential number that identifies their Plantation Lots. Furthermore, there is an intention, although not an obligation, for the RE to allocate the Plantation Lots of each Investor to different geographical regions in order to reduce risk for that Grower;
- (f) the services provided by the RE to each Grower under the Project Constitution include:
- (i) purchasing seedling Trees;
 - (ii) planting approximately the Required Number of Trees per quarter hectare and doing all things necessary to ensure that the seedling Trees are tended according to principles of good farming practice and sound agricultural methods. These services will be carried out within 18 months after the time an amount is first received from a Grower under the Timber Project;
 - (iii) controlling vermin and weeds to maintain Tree growth;
 - (iv) managing Tree nutrition;
 - (v) maintaining firebreaks, access tracks and water supply points for fire suppression purposes and complying with all reasonable directions and all statutory requirements in relation to the prevention and control of fire;
 - (vi) liaise with the relevant governmental authorities with respect to fire suppression and prevention;
 - (vii) maintaining a plantation inventory for the establishment of permanent growth plots and measurement at regular intervals (nominally at 1, 3, 5, 7 and 9 years of age);
 - (viii) monitoring plantation health throughout the year;
 - (ix) liaising with the community and government in terms of dealings with neighbours, local government and regulatory authorities etc with respect to the ongoing management of the Grower's Plantation Lots;

- (x) manage any grazing by livestock on the Land after 2 years following planting or such earlier time as agreed by the RE and Forestry Manager (it is understood that grazing will only be allowed where the Trees will have grown sufficiently so as not to be adversely affected by grazing activities);
 - (xi) generally keeping the Land clean, tidy and in a condition suitable for the conduct of the Grower's 'forestry interests';
 - (xii) where reasonably required, maintaining fencing for the protection of the Grower's Plantation Lots and thereby the Trees of that Grower;
 - (xiii) employing such staff and labour as are necessary including, without limitation, engaging the services of such consulting experts as may be necessary to assist the RE in providing expert advice and assistance with respect to the growing of the Trees;
 - (xiv) doing all other things that are necessary or incidental to the growing of the Trees for felling or sale when they are sufficiently mature;
 - (xv) if necessary, arranging for either or both harvesting and sale of the Timber;
 - (xvi) report to the Grower on an annual basis as to matters which the Manager determines the Grower should be informed of;
 - (xvii) acting as the Grower's representative, exercising all of the Grower's rights and performing all of the Grower's obligations in respect of their Plantation Lots and the Trees; and
 - (xviii) collecting any other revenue derived from the Grower's Plantation Lots.
- (g) each Grower's produce (that is, the Trees on the Grower's Plantation Lots) will be pooled with the produce from other Growers' Plantation Lots in the Project and sold together, with the proceeds divided according to the proportionate number of Interests the Grower has in the Project.

The only exception to this is where the Grower's produce is significantly reduced (for example, due to fire). In the case where the Grower's Plantation Lots produce no Trees (for example, because they are all destroyed by fire), the Grower would not participate in any sale proceeds (but would receive the proceeds of any insurance).

Where only some of the Trees on the Grower's Plantation Lots are destroyed, the Grower will share in the sale proceeds in accordance with the proportional interest the Grower retains in the Project, as determined by the Manager (refer to the definition of Grower's Proportional Interest in clause 25 of the Project Constitution). Whilst the method used to determine the proportional interest will depend upon the nature of the event, the general principle will be to determine the proportion of the remaining Trees and their relative market value, as they relate to the Trees that would have been expected on the Plantation Lots leased to that Grower; and

- (h) the RE may withhold an amount from payments to the Grower for any Tax which may be required to be withheld at the time that the payment is made. This clause provides the flexibility to cover any withholding that may be required due to a change in the tax laws or the circumstances of the Grower in the intervening period.

57. Growers may also elect to obtain insurance in respect of their Trees, which will reduce risk of loss associated with destruction or damage to their Trees. If the Trees are destroyed, it will only be practicable to replant the Trees within the first two years of the Trees being planted as, after this two year period, the Trees would not grow sufficiently to be harvested with the rest of the plantation (that is a minimum eight years of growth is expected to be required to produce Trees of merchantable quality). Where the Trees are not replanted, MAAML will pay the insurance proceeds to the Grower (as described below). There will be no pooling of the insurance proceeds with the Net Sale Proceeds.

Compliance Plan

58. As required by the Corporations Act, MAAML, as RE, has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that MAAML manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of the Growers are protected.

Agreement for Ground Lease, Sub-Lease and Forest Property Agreement

59. MAAML will enter into an agreement under which it agrees to obtain a Lease and Forest Property Agreement over suitable Land for the Project (clause 2). Once suitable Land has been obtained by the land owner, MAAML will enter into a Lease granted by the land owner which confers on MAAML:

- (a) rights to exclusive possession of the Land the subject of the Lease; and

- (b) the right to plant, maintain and harvest the Trees on the Land.

60. In addition, MAAML will enter into a Forest Property Agreement with the land owner under the *Forestry Rights Act 1996* (Vic), which will provide that ownership of the Trees planted on the Land, any product of those Trees and the carbon sequestered by those Trees is vested in MAAML. MAAML's rights under the Lease and Forest Property Agreement will be assignable.

61. Once a Lease has been obtained by MAAML, MAAML will grant a Sub-Lease over the Land to the Custodian (refer to clause 3 of the Agreement for Ground Lease, Sub-Lease and Forest Property Agreement), who holds the Sublease for the benefit of the Growers (Custody Agreement – Notice of Addition: Schedule 2 – Additional Terms in respect of Additional Scheme), which allows each Grower:

- (a) rights to exclusive possession of particular Plantation Lots on the Land the subject of the Sublease; and
- (b) the right to plant, maintain and harvest the Trees on those particular Plantation Lots.

62. In addition, MAAML will assign its Forest Property Rights under the Forest Property Agreement to the Custodian such that ownership of the Trees planted on the Land, any product of those Trees and the carbon sequestered by those Trees is vested in the Custodian for the benefit of the relevant Growers.

63. The Custodian will hold the benefit of the Sub-Lease and Forest Property Agreement as to each separate Plantation Lot on trust for each Grower. Thus, each Grower will have the benefit of all rights of possession and occupation and all rights to the produce of the Land in respect of their particular Plantation Lot.

64. The Custodian will subsequently grant a licence to MAAML which permits MAAML and all subcontractors and agents of MAAML to enter the Land for the purposes of carrying out their contractual services (refer to clause 1 of the Sub-Lease).

Midway Off-Take Agreement 2011

65. The RE, on behalf of each Grower, will market the Timber in this capacity.

66. In this capacity, the RE, on behalf of each Grower, will enter into an Off-Take Agreement with the Off-Takers. Currently Midway has agreed to off take for both the Geelong (Midway-managed) and Portland (McEwens-managed) regions.

67. Under this agreement, Midway will agree to purchase the Grower's standing Trees at year 11 (that is, the trees will be sold 'at stump').

68. Midway will be required to offer a price for the standing Trees at the market price then prevailing and Midway shall be responsible for harvesting, transporting, chipping and marketing of the product. If the Growers (through the RE as the representative of the Growers under the Midway Off-Take Agreement) do not accept the price offered, then a negotiation and arbitration provision can be invoked by the RE.

MFSP Management Agreement 2011

69. Under this Agreement MAAML engages Macquarie Forestry Services Pty Limited (MFSP) to undertake certain of its obligations under the Constitution for the Term of the Project.

70. MAAML grants to MFSP a licence to access and use (and to allow its subcontractors and agents to access and use) the Land and Other Land for all purposes necessary to carry out its obligations under this Agreement.

71. This Agreement commences on the Commencement Date and continues until the Termination Date. In terms of clause 13.4, the Termination Date is the same as that for the Project Constitution.

Midway Management Agreement 2011

72. Under this Agreement MFSP sub-contracts some of its obligations under the MFSP Management Agreement to Midway in respect of the Geelong region and potentially other regions.

73. MFSP and Midway agree and acknowledge that the Growers are to sell Timber from Plantation Lots to Midway, in accordance with the terms of the Off-Take Agreement.

McEwens Management Agreement 2011

74. Under this Agreement MFSP sub-contracts some of its obligations under the MFSP Management Agreement to McEwens in respect of the Portland region.

75. MFSP and MAAML will each establish an account (together the 2011 Forestry Accounts) into which they will deposit moneys that (together with the interest earned on those moneys) are expected to be sufficient to pay the expected expenses associated with planting and establishment and annual forestry and ongoing maintenance that are currently anticipated to be incurred for the Project. A charge will be granted by each of MFSP and MAAML (in its personal capacity) to the Custodian of the Project, as security for the performance of the obligations to provide these services. In the unlikely event that MFSP and MAAML become insolvent and are unable to perform their obligations to Growers in the Project, then the Project will be able to use the funds in the 2011 Forestry Accounts and apply these funds toward the Project expenses.

76. MFSPL and McEwens agree and acknowledge that the Growers are to enter into arrangements to sell Timber from Plantation Lots in the Portland region to an off taker. McEwens agrees to provide access at least annually for representatives of any contracted off taker to inspect the Plantation Lots in the Portland region. Such access will be granted at a mutually agreeable time.

Custody Agreement

77. The RE has appointed the Custodian as the custodian of the Assets of the Project under a Custody Agreement. The Custodian will hold the Assets of the Project on the RE's behalf and for the benefit of the Growers.

Fees

78. The fees payable under the Constitution of the Macquarie Eucalypt Project 2011, on an Interest basis, are as follows:

- (a) an up-front application fee of \$2,585 per Interest (Application Fee) will be paid to the Manager by each Grower on application as consideration for the RE's provision of services to the Grower. Where MAAML rejects a prospective Grower's application to be issued an Interest in the Project, this amount will be refunded to the prospective Grower at the time that they are notified of their rejection;
- (b) a Deferred Management Fee of 5.5% of the Net Sale Proceeds (and a Productivity Performance Fee (see below)) will be payable by each Grower to the RE as consideration for the RE's provision of management services during the balance of the term of the Project. (Refer to clause 18.2 of the Project Constitution). If no sale proceeds are received (for example, because the Trees are destroyed by fire), the Deferred Management Fee will equal:
 - 5.5% of any insurance proceeds received by the Grower; or
 - if no insurance proceeds are received (irrespective of whether an event occurs) – nil;

- (c) the Productivity Performance Fee payable by each Grower to the RE, will be an amount equal to 16.5% of any Net Sale Proceeds in excess of \$4,000 per Interest where the average yield on the plantation is greater than 60 GMT per Interest. For these purposes, the calculation of the Productivity Performance Fee will be based on the performance in each region, pursuant to clause 18.3 and the definitions of Net Sale Proceeds and Productivity Performance Fee in clause 25 of the Project Constitution. No Productivity Performance Fee is payable with respect to any Net Sales Proceeds received separately from any Residual Timber; and
- (d) a Deferred Rent of 4.95% of Net Sales Proceeds, Tree Insurance Proceeds will be payable by each Grower to the RE as consideration for rent during the term of the Project.

Finance

79. Investors may apply to MBL to provide a loan (the Investment Loan) to fund their Investment costs payable on application for the Project. There is flexibility for the Investment Loan to be extended to cover any loan application fee pursuant to the definition of Facility Limit in clause 21.1 of the Loan and Security Agreement.

80. If the Investor's application is approved, MBL will enter into the Loan and Security Agreement with the Investor under which:

- (a) MBL will advance up to 100% of the funds required by an Investor to finance the costs of the Investment paid on application;
- (b) the loan options will be:

Term	1 year	5 years	7 years
Investment amount able to be borrowed	100%	100%	100%
Indicative Interest Rate⁸	No interest	9.99%: set on an arm's length commercial basis	11.99%: set on an arm's length commercial basis

⁸ Actual interest rates charged will be set on the day the loan is approved and may differ from the numbers stated depending on prevailing bank bill swap rates at the time and credit conditions prevailing at the time.

Interest Rate Set Date	N/A	Interest rates will be set on the day the loan is approved.	Interest rates will be set on the day the loan is approved.
Loan Approval Date	Within 1 month of the RE receiving the Investor's application	Within 1 month of the RE receiving the Investor's application	Within 1 month of the RE receiving the Investor's application
Amortisation Profile⁹	1 year of equal monthly principal repayments	5 years of equal monthly payments	7 years of equal monthly payments
Interest Payments	N/A	Monthly in arrears	Monthly in arrears
Application Fee	1% of Loan Amount	\$0	\$0

- (c) the Investor will provide security to MBL over their interests in the Investment, which may include their rights under the various agreements comprising their Interest in the Project;
- (d) MBL will be able to enforce its security in the event of default. Events of default include non payment, bankruptcy, breach of representations/warranties and undertakings;
- (e) Investors will remain fully liable for the balance of the loan outstanding at any time and MBL will take legal action against defaulting borrowers;
- (f) there are no indemnity arrangements or any other collateral agreements in relation to the loan; and
- (g) Investors have no right to assign their rights and obligations under the loan.

81. The loan will be a full recourse loan, with the consequence that the Investor will be required to make up the difference from their own funds if the realisation of the security does not yield sufficient proceeds to repay the loan as the repayments of principal and payments of interest under the loan will not be linked to proceeds derived by Investors from their Investment.

⁹ Monthly payments of principal and interest will commence the month following the Drawdown Date.

82. 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 MBL, are involved or become involved in the provision of finance to Growers for the Project.

Appendix 1 – Explanation

❗ *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

83. In return for payment of the Application Fee and the other fees and expenses required under the Constitution 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)).

84. Under the Constitution 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 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’¹⁰ in the Project.

Is the Grower carrying on a business?

85. 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?

86. 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; (2008) 74 ATR 644 applied these principles to conclude that ‘Growers’ in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

87. Application of these principles to the arrangement set out above leads to the conclusion that Growers (as described in paragraphs 4 to 6 of this Ruling), who take out insurance over their Trees and who stay in the Project until its completion, will be carrying on a business of primary production involving afforestation activities.

¹⁰ The term ‘participant’ is defined in subsection 394-15(4).

Allowable deductions

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

88. 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 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

89. 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 have been reasonable to expect that on 30 June 2011, the amount of 'direct forestry expenditure'¹¹ under the scheme will be no less than 70% of the amount of payments under the scheme.¹²

90. The amount of all 'direct forestry expenditure' is the amount of the net present value of all 'direct forestry expenditure' that the MAAML, as 'forestry manager'¹³ of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

91. 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)).

92. Both of the above amounts are determined as at 30 June 2011 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).

93. Applying all of these requirements to the information provided by MAAML (as the Responsible Entity of the Project) the Commissioner has determined that the Project will have satisfied the '70% DFE rule' on 30 June 2011.

¹¹ See section 394-45.

¹² See subsection 394-35(1) and section 394-40.

¹³ Defined in section 394-15(2).

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

94. 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 is clear from the Project Agreements as are the alternative elements of paragraph 394-10(1)(e) relating to the number of Growers in the scheme and MAAML's role in other managed investment schemes.

95. The final requirement for deductibility requires all the Project trees to be established within 18 months of 30 June 2011 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Ruling by MAAML indicates that all the trees required to be established under the scheme will be planted on the Project land by 31 December 2012.

96. Accordingly, subject to the qualifications set out below, amounts paid by Growers to MAAML in relation to 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)).

97. Amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

98. 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 subsection 394-10(1)

99. Two situations may lead to a loss of deductions previously allowed to Growers under subsection 394-10(1).

100. The first of these situations will occur if MAAML fails to establish the trees on the Project land within 18 months. Where this occurs MAAML 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).

101. 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 Application Fee (see subsection 394-10(5)).

102. 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).

103. 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

104. 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).

105. 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).

106. 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 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.

107. 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).

108. 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

109. 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 section 82KZMF of the ITAA 1936.

110. 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.

111. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with MBL will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Ruling applies (see paragraphs 79 to 82 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.

112. 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

113. 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)).

114. In this Project the Investment Loan establishment fee payable to MBL is 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.

115. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the amount exceeds \$100, the deduction for the 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

116. 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)

117. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)¹⁴ 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 99 to 101 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

¹⁴ A thinning under this scheme is not a 'CGT event'.

Market value rule applies to 'CGT events'

118. 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.

119. 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)).

120. 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.

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

121. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the year ended 30 June 2011 who carries on a business of afforestation individually (alone or in partnership) is expected to incur losses from their participation in the Project which will be subject to Division 35.¹⁵ 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.

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

123. 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.

¹⁵ Division 35 does not apply to Growers who do not carry on a business or who carry on a business other than as individuals (alone or in partnership).

124. Where a Grower with income for NCL 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 afforestation 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 35-10(2C).

125. Where a Grower with income for NCL purposes of \$250,000 or more (that is, 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 afforestation 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).

126. 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.

127. In each individual year where the Commissioner's discretion is exercised a Grower within either paragraphs 124 or 125 of this Ruling 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.

Section 82KL – recouped expenditure

128. 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

129. 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).

130. The Macquarie Eucalypt Project 2011 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 31 and 35 to 37 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.

131. 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.

132. A Grower can rely on this Ruling and the Commissioner will not apply Part IVA of the ITAA 1936 to deny the tax deductions set out in paragraphs 31 and 35 to 37 of this Ruling by reason of a Grower acquiring units in the Land Trust.

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Not previously issued as a draft

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

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