

PR 2012/6 - Income tax: Premium African Mahogany 2012 Project

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *11 April 2012*



Product Ruling

Income tax: Premium African Mahogany 2012 Project

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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 Premium African Mahogany 2012 Project, or simply as 'the Project'.

2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Ruling, 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 Investors.

5. Investors 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. An Investor will have applied for an interest in the Project on or before 30 June 2012 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 2012
- 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 Price is not paid in full to Lowell Capital Limited by 30 June 2012, either by the Investor or on the Investor'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 43 to 73 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 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.

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Date of effect

12. This Product Ruling applies prospectively from 11 April 2012, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 11 April 2012 until 30 June 2012, 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 Constitution.

13. However this 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 Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after this Product Ruling is issued.

Goods and Services Tax

17. All amounts and percentages referred to in this Product Ruling exclude the Goods and Services Tax (GST), unless otherwise specified. The transactions in respect of this scheme may, where appropriate, have GST implications.

Ruling

Structure of the Project

18. The Premium African Mahogany 2012 Project (the Project) is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of *Khaya senegalensis* (African mahogany) trees for felling in Australia. Investment in the Project is stapled to an investment in the Mahogany Land Trust. The Mahogany Land Trust is not a forestry management investment scheme as defined in subsection 394-15(1). This Ruling only addresses the tax consequences of participation in the Project.

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 3 to 7 above) who is accepted to participate in the 'forestry managed investment scheme' described below at paragraphs 43 to 73 on or after 11 April 2012 and on or before 30 June 2012.

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).

Minimum subscription

21. An Investor is not eligible to claim any tax deductions until their application to enter the Project is accepted and the Project has commenced. Under the terms of the Product Disclosure Statement, the Project will not proceed until the minimum subscription of 500 forestry interests and 500 Mahogany Trust Units are achieved.

Carrying on a business

22. An Investor (as described in paragraphs 4 to 6) in the Project is not considered to be carrying on a business of primary production.

¹ See subsection 394-15(5).

² See section 394-30.

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

Section 394-35 and subsection 394-10(4)

23. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by Lowell Capital Limited. On the basis of that information the Commissioner has decided that on 30 June 2012 it will be reasonable to expect that the '70% DFE rule'³ will be satisfied. The Australian Taxation Office (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'.

24. The Ruling will only apply if Lowell Capital Limited establishes all of the trees that were intended to be established under the Project within 18 months of the end of the income year in which the first 'participant' in the Project is accepted.⁴ For this Project the trees must be established by 31 December 2013.

25. 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 1,030 stems per hectare. Lowell Capital Limited is required by section 394-10 of Schedule 1 of the *Tax Administration Act 1953* to notify the ATO if all of the trees are not established by 31 December 2013.

Allowable deductions

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

26. An Investor in the Project can claim deductions for amounts paid to Lowell Capital Limited as shown in the Table below (sections 8-5 and 394-10).

27. The deductibility of these amounts remains subject to a requirement that a CGT event⁵ does not happen in relation to the Investor's 'forestry interest' within four years of the Investor first paying an amount under the scheme (see paragraphs 31 to 34 below).

28. The amount is deductible in the income year in which it is paid, or is paid on behalf of the Investor (subsection 394-10(2) and section 394-20). This requires cash to flow from the Investor, or from another entity on the Investor's behalf, to Lowell Capital Limited'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 Lowell Capital Limited's bank account will not qualify for a deduction under subsection 394-10(2).

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

⁴ See subsection 394-10(4)

⁵ Defined in section 995-1.

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29. Where an Investor 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.

30. 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
Initial contribution	\$9,000 per interest	30 June 2012
Annual contribution	Tending fee of \$700 per interest per annum to manage the plantation and meet the rental costs, indexed annually from 30 June 2012.	Any year in which the relevant amount is paid See Note (ii)
Deferred management contribution	65% of the proceeds of sale of the second thinning of Trees on the plantation	Any year in which the relevant amount is paid

Notes:

- (i) The Initial contribution is for the establishment services as outlined in Item 1 of Schedule 4 of the Constitution (as well as the fees and costs of operating the Project, as contemplated in the Constitution).
- (ii) The annual contribution is payable each year from the date of planting the trees and will continue until the trees have been harvested. The fee will be indexed annually from 30 June 2012. The annual contribution is for the management services as outlined at Item 2 of Schedule 4 of the Constitution.

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

31. Deductions for the Initial contribution, and the Annual contribution that have been allowed as deductions under 394-10 in the first four years are not allowable where a 'CGT event' happens in relation to the 'forestry interest' of an Investor before 1 July 2016 (subsection 394-10(5)).

32. Where deductions for these amounts have already been claimed by an Investor 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.

33. Investors 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'.

34. However, deductions will not be affected where the 'CGT event' happens because of circumstances outside the Investor's control and the Investor could not reasonably have foreseen the 'CGT event' happening when they acquired the 'forestry interest' (subsection 394-10(5A)).

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

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

35. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁶ – see below at paragraph 38) happens to a 'forestry interest' held by an Investor 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 Investor (sections 6-10 and 394-25), less any GST payable on those proceeds (section 17-5).

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

37. '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 Investor; or
- any other 'CGT event' that results in a reduction of the market value of the 'forestry interest' held by the Investor.

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

Amounts received by Investors where the Project trees are thinned, Carbon and other environmental credits**Section 6-5**

38. An amount received by an Investor in respect of a thinning of the trees grown in this Project is not received as a result of a 'CGT event' and is not otherwise assessable under Division 394. The amount is a distribution of ordinary income that arises as a result of an Investor holding a 'forestry interest' in the Project. Investors include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5) less any GST payable on those proceeds (section 17-5).

39. An amount received by an Investor in respect of carbon and/or other environmental credits under the Project also constitutes a distribution of ordinary income that arises as an incident of the Investor holding a 'forestry interest' in the Project. Investors include such amounts received in their assessable income in the income year in which those amounts are derived (section 6-5).

Units**Part 3-1**

40. The Units in the Mahogany Land Trust are CGT assets (section 108-5) and the amount paid by an Investor to acquire these assets is an outgoing of capital and not allowable as a deduction.

41. The amount paid for each Unit will represent the first element of the cost base of the Unit (subsection 110-25(2)). Any disposal of the Units by an Investor will be a CGT event and may give rise to a capital gain or loss.

Prepayment provisions, non commercial losses, and anti-avoidance provisions***Division 35 of the ITAA 1997, sections 82KZM, 82KZME, 82KZMF, 82KL and Part IVA of the ITAA 1936***

42. Where an Investor is accepted to participate in the Project set out at paragraphs 43 to 73, the following provisions of the ITAA 1936 or the ITAA 1997 have application as indicated:

- losses arising from participation in the Project are not within the scope of Division 35;
- 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

43. 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 19 December 2011;
- Additional correspondence dated 11 January 2012;
- Amended documents and additional correspondence received on 7 February 2012;
- Amended documents and additional correspondence received on 24 February 2012;
- Amended documents and additional correspondence received on 30 March 2012;
- Amended documents and additional correspondence received on 2 April 2012;
- Draft Product Disclosure Statement for the Premium African Mahogany 2012 Project issued by Lowell Capital Limited as the Responsible Entity, received on 2 April 2012;
- Constitution for the Premium African Mahogany Project 2012 dated 6 February and received on 2 April 2012;
- Compliance Plan for the Premium African Mahogany 2012 Project dated 31 December 2011 and received on 19 December 2011;
- Draft Project Management Agreement between Lowell Capital Limited and Northern Australia Project Management Pty Ltd dated 9 December and received on 19 December 2011;
- Draft Forestry Management Agreement between Northern Australia Project Management Pty Ltd and African Mahogany Australia Pty Ltd dated 14 December 2011 and received on 2 April 2012;
- Draft lease between the Lessor and Lowell Capital Limited dated 15 December 2011 and received on 19 December 2011;
- Constitution – Lowell Mahogany Land Trust dated 6 February 2012 and received on 24 February 2012; and
- Compliance Plan for the Mahogany Land Trust received on 19 December 2011.

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

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

45. 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 an Investor, or any associate of an Investor, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

Overview

46. The main features of the Premium African Mahogany 2012 Project are as follows:

Location	The Douglas Daly region of the Northern Territory.
Species of trees to be planted under the scheme	Khaya senegalensis (African Mahogany)
Term of the Project	Approximately 18 years
Date all trees must be planted on scheme land	31 December 2013
Number of trees per hectare	1,030
Number of hectares offered for cultivation	Approximately 1,000
Size of each 'forestry interest'	1 hectare
Minimum allocation of 'forestry interests' per Investor	1 interest
Minimum subscription	500 interests in the Project and 500 units in the Land Trust
Initial cost	\$9,000 per interest
Ongoing costs	Annual contribution of \$700 per interest per annum, indexed annually from 30 June 2012 at the greater of 3% or CPI
Other costs	Deferred management contribution will be a percentage of thinning proceeds. The fee will be equal to 65% of the harvest proceeds for the second thinning of the trees. In addition, the investors will be required to contribute an amount to cover the costs of insurance for the plantation to the extent such insurance is available and can be secured at an economically viable cost.

47. The Project is a registered managed investment scheme under the *Corporations Act 2001*. Lowell Capital Limited has been issued with an Australian Financial Service Licence Number 241175 and is the Responsible Entity for the Project. Lowell Capital Limited is also the responsible entity for the Mahogany Land Trust.

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48. The Project is called the Premium African Mahogany 2012 Project and is a forestry management investment scheme. Investment in the Project is stapled to an investment in the Mahogany Land Trust. The Mahogany Land Trust is not a forestry management investment scheme. This Ruling only addresses the tax consequences of participation in the Project.

49. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 1,000 'forestry interests' which corresponds to approximately 1,000 hectares although oversubscriptions may be allowed, where sufficient land for the Project can be sourced.

50. An entity that participates in the Project as an Investor will do so by acquiring a 'forestry interest' in the Project on or before 30 June 2012, which will consist of a minimum of one forestry interest each of 1 hectare in size. For each interest acquired in the Forestry Project, Investors must also acquire a unit in the Mahogany Land Trust. The Initial contribution for an interest in the Project is \$9,000 per interest. Application price for a unit in the Land Trust is \$2,500 per unit.

51. Each applicant must complete the Application Form in the PDS and make a payment, equal to the Initial Contribution for the Forestry Interests and land trust units subscribed. By signing the Application Form, the applicant agrees to be bound by the terms of the Constitution for the Premium African Mahogany 2012 Project and the Constitution for the Mahogany Land Trust.

52. Under terms of the Constitution, 'forestry interests' will be issued on the date the Responsible Entity accepts the Applicant's application. The PDS states that the Forestry Project and the Land Trust will only proceed if a minimum subscription of 500 stapled units has been achieved.

53. The Land Trust has identified land for the Project within the Douglas Daly region of the Northern Territory. Land for this Project must meet the requirements set out by the Independent Forester at page 40 of the draft PDS.

54. Only previously cleared agricultural land will be acquired for the Project.

Constitution

55. The Constitution of the Premium African Mahogany 2012 Project establishes the Project and operates as a deed binding each Investor and Lowell Capital Limited. The Constitution of the Premium African Mahogany 2012 Project sets out the terms and conditions under which Lowell Capital Limited agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Investors are bound by the Constitution by virtue of their participation in the Project.

56. In order to acquire an interest in the Project, an entity must make an application for an 'interest' in accordance with clause 6.1. Among other things, the application is to be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, and if approved by the Responsible Entity may be lodged electronically. The application must be accompanied by any other documentation which the Responsible Entity may require from time to time. Application Money must be paid to the Responsible Entity with the application for an Interest in a form approved by the Responsible Entity

57. Under clause 14 of the Constitution, the Responsible Entity holds the Application Money on trust for the Applicants. The Application Fund must be maintained for the purposes of depositing all money received from applicants and accrued interest.

58. Once the Responsible Entity has accepted the application and an Interest has been issued to the Applicant, the Responsible Entity may transfer money paid by the Applicant out of the Application Fund and into the Project Fund. The Responsible Entity may only withdraw money from the Project Fund for application against fees and costs and purposes disclosed in clause 16.

59. If the Application Money remains in the Application Fund for 12 months after it was received by the Responsible Entity, then the Application Money must be refunded to the Applicant unless the Applicant directs the Responsible Entity in writing to hold the money for a further period.

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

- the purpose of the Project, clause 4;
- interests of Applicants and investors in the Application and Proceed Funds, clause 7;
- the transfer of the Investor's interest in the Project, clause 10;
- investors' default, clause 13;

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- Investor's income and distributions, clauses 17 and 18;
- Responsible Entity's powers, clause 22 and rights, clause 23;
- withdrawal rights, clause 24;
- Complaints Handling, clause 25;
- the right of the responsible entity to be paid fees and other expenses, clause 27;
- the Responsible Entity's obligations in relation to the establishment and maintenance of the plantation, clause 20 and Schedule 4; and
- winding up the Project, clause 32.

Compliance Plan

61. As required by the Corporations Act, Lowell Capital Limited has prepared a Compliance Plan for the Premium African Mahogany 2012 Project. The purpose of the Compliance Plan is to ensure Lowell Capital Limited manages the Project in accordance with its obligations and responsibilities contained in the Constitution and the interests of Investors are protected.

Head Lease

62. The Responsible Entity will secure land (the Project Land) by entering into a lease with the Responsible Entity or Custodian of the Lowell Mahogany Land Trust to secure plantation land for the Project before 30 September 2013. The head lease sets out the terms and conditions under which the Lessor will lease the Project Land to Lowell for the purpose of growing, tending and harvesting plantation trees planted on the Land.

63. The Lessor acknowledges that plantation trees planted on the Land and any rights, benefits and credits derived from such trees are the property of Lowell Capital Limited. The head lease will be current for the term of the Project.

64. Units in the Lowell Mahogany Land Trust will be stapled to interests in the Project, such that Investors in the Project will also be investors in the Trust.

Project Management Agreement

65. Under the Project Management Agreement, Lowell Capital Limited as Responsible Entity appoints Northern Australia Project Management Pty Ltd (NAPM) to manage the Project on the terms set out in this agreement. NAPM will provide project management services as set out in Schedule 1 including:

- Project Development;
- Project Marketing;
- Project Administration;
- Plantation Management; and
- Plantation Produce Marketing.

66. The agreement automatically terminates upon termination of the Project in accordance with or as contemplated by the Constitution. Clause 10 states that NAPM may, for the better performance of its obligations under this Agreement, employ agents, contractors, professional advisors and other consultants.

Forestry Management Agreement

67. NAPM appoints African Mahogany Australia Pty Ltd (AMA) to provide certain forestry services for the Project on the terms set out in this Agreement. This Agreement automatically terminates upon termination of the Project in accordance with or as contemplated by the Constitution.

Entitlement to Net Proceeds

68. The Constitution (clauses 17.4 and 17.5) sets out Investors' entitlement to their share of the Proceeds Fund or insurance proceeds in the event of loss or damage to the trees. This Product Ruling applies on the basis that all Investors in the Project have an interest in the Proceeds Fund.

Contributions

69. Under the terms of the Constitution of Premium African Mahogany 2012 Project, an Investor will make payments as described below on a per 'interest' basis.

Contributions payable under the Constitution:

- Initial Contribution for plantation establishment services of \$9,000 per Interest, payable on application;
- Deferred management fees of 65% of the Harvest Proceeds from the second thinning of the Trees;

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- Annual contributions of \$700 per Interest per annum, indexed annually from 30 June 2012 at the greater rate of 3% or CPI; and
- Insurance contribution, to cover the cost of insurance of the plantation. The total cost of insurance will be divided by the number of Interests on issue to calculate a cost of insurance per Interest, which each investor will be required to pay per Interest held in the Project.

Finance

70. There is no financing facility offered by the Responsible Entity, an associate of the Responsible Entity or any other party to the scheme. Investors can fund their investment in the Project themselves, or borrow from an independent lender. Investors cannot rely on any part of this Product Ruling if the Application Funds are not paid in full on or before 30 June 2012.

71. An Investor who enters into a finance arrangement with an independent lender may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

72. An Investor cannot rely on any part of this Ruling if the contributions are not paid in full on or before 30 June 2012 by the Investor or, on the Investor's behalf, by a lending institution.

Other qualifications relating to finance

73. This Ruling does not apply if the finance arrangement entered into by the Investor 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, are involved or become involved in the provision of finance to Investors for the Project.

Commissioner of Taxation

11 April 2012

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Structure of the Project

74. In return for payment of the Initial contribution and the other fees and expenses required under the Project Agreements during the term of the Project, Investors 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))

75. Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Investor a right to a share in the proceeds of the harvest and share of the proceeds of any thinning of the trees grown on the Project land. That share of proceeds is determined using the number of 'forestry interests' held by an Investor as a proportion of all 'forestry interests' held by 'participants'⁷ in the Project.

Is the Investor carrying on a business?

76. 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?*

77. 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 'Investors' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90; ATR 90).

78. Application of these principles to the arrangement set out above leads to the conclusion that an investor (as described in paragraphs 4 to 6), in the Premium African Mahogany 2012 Project is not considered to be carrying on a business of primary production involving forestry activities.

Allowable deductions

Sections 8-5, 12-5, 394-10, and 394-20 of the ITAA 1997

79. 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).

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

The '70% DFE rule'***Paragraph 394-10(1)(c) and section 394-35***

80. The threshold test for Investors in the Project to be entitled to deductions under subsection 394-10(1) is the '70% DFE rule' in paragraph 394-10(1)(c). Under that rule it must be reasonable to expect that on 30 June 2012, the amount of 'direct forestry expenditure'⁸ under the scheme will be no less than 70% of the amount of payments under the scheme.⁹

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

82. 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)).

83. Both of the above amounts are determined as at 30 June 2012 taking into account

- the timing requirements in subsections 394-35(4) and 394-35(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).

84. Applying all of these requirements to the information provided by Lowell Capital Limited, the Commissioner has determined that the Project will satisfy the '70% DFE rule' on 30 June 2012.

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

85. The requirement of paragraph 394-10(1)(d) that Investors in the Project not have day to day control over the operation of the Project (despite having a right to be consulted or give directions) is clear from the Project Agreements as are the alternative elements of paragraph (e) relating to the number of Investors in the scheme and Lowell Capital Limited's role in other managed investment schemes.

⁸ See section 394-45.

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

¹⁰ Defined in section 394-15(2).

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86. The final requirement for deductibility requires all of the Project's trees to be established within 18 months of 30 June 2012 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Ruling by Lowell Capital Limited indicates that all the trees required to be established under the scheme will be planted on the Project land by 31 December 2013.

87. Accordingly, subject to the qualifications set out below, amounts paid by Investors to Lowell Capital Limited 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)).

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

89. Where an Investor 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)

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

91. The first of these situations will occur if Lowell Capital Limited fails to establish the trees on the Project land within 18 months. Where this occurs the Lowell Capital Limited is required to notify the Commissioner within three months of the end of the 18 month period (section 394-10 of Schedule 1 to the TAA).

92. The second situation where an Investor may have deductions disallowed is where a 'CGT event' happens to their 'forestry interest' within four years from 30 June of the income year they paid an amount under the scheme, for example, the Initial Contribution (see subsection 394-10(5)).

93. For the purposes of this provision, the Commissioner is able to amend the assessment of an Investor within two 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)).

94. Where a 'CGT event' happens to the 'forestry interest' of an Investor within four 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 Investor 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.

95. However, subsection 394-10(5) will have no application where the 'CGT event' happens because of circumstances outside the Investor's control and the Investor could not reasonably have foreseen the 'CGT event' happening when they acquired the 'forestry interest' (subsection 394-10(5A)).

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

Sections 6-10, 10-5, and 394-25 of the ITAA 1997

96. 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)

97. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning¹¹) happens to a 'forestry interest' held by an Investor in this Project, subsection 394-25(2) includes an amount in the assessable income of the Investor if:

- the Investor can deduct or has deducted an amount under section 394-10; or
- the Investor would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 31 to 34 and paragraphs 90 to 95 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to' CGT events'

98. If, as a result of the 'CGT event' the Investor either:

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

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

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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 Investor 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.

99. The market value amount included in the assessable income of an Investor is the value of the 'forestry interest' just before the 'CGT event', or where the Investor 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)).

100. 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.

Amounts received by Investors where the Project trees are thinned, Carbon and other Environmental Credits

Section 6-5

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

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

103. An amount received by an Investor in respect of carbon and/or other environmental credits under the Project also constitutes a distribution of ordinary income that arises as an incident of the Investor holding a 'forestry interest' in the Project. Investors include such amounts received in their assessable income in the income year in which those amounts are derived (section 6-5).

Recouped expenditure

Section 82KL of the ITAA 1936

104. 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.

General tax avoidance provisions***Part IVA of the ITAA 1936***

105. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C of the ITAA 1936) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D of the ITAA 1936).

106. The Premium African Mahogany 2012 Project will be a 'scheme' and an Investor will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraphs 26 to 30 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.

107. Investors 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 Investors 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 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 Investors will enter into the scheme for the dominant purpose of obtaining a tax benefit.

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/11; TR 98/22

Subject references:

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

Legislative references:

- ITAA 1936 82KL
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- ITAA 1936 82KZM
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
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- ITAA 1936 170
- ITAA 1936 177A
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- ITAA 1936 318
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