PR 1999/16 - Income tax: Great Southern Blue Gum Plantations 2000 Project

Product Ruling
Income tax: Great Southern Blue Gum Plantations 2000 Project

Contents Para

Contents	Para
What this Product Ruling is about	**1**
Date of effect	**9**
Withdrawal	**11**
Arrangement	**12**
Ruling	**27**
Explanations	**31**
Detailed contents list	**46**

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Great Southern Blue Gum Plantations 2000 Project, or 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997') and sections 82KL and 82KZM and Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936').

Class of persons

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the

arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance that the prices charged for the product are reasonable, appropriate or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 26) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

Date of effect

9. This Ruling applies prospectively from 28 April 1999, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered

by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2000. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Prospectus issued by Great Southern Managers Australia Limited on 17 February 1999;
- **Lease and Management Agreement** between Great Southern Managers Australia Limited (‘GSMAL’) and the Grower;
- Constitution of the Great Southern Blue Gum Plantations Project dated 18 December 1998;
- Compliance Plan for Project as adopted by GSMAL on 18 December 1998;
- **Application for Finance for Principal and Interest Loans**;
- **Loan Agreement** between Templegate Finance Pty Ltd (‘TFPL’) and the Borrower;
- Draft Management Service Agreement between GSMAL and Templegate Services Pty Ltd; and
- Draft Plantation Management Agreement between GSMAL and Templegate Services Pty Ltd;
- Mortgage Debenture between GSMAL, as Financier, and TFPL, as Mortgagor;

- Intercompany Loan Offer facility letter from GSMAL to TPFL; and
- Letters from PriceWaterhouseCoopers dated 22, 24 and 31 March 1999.

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

13. The documents highlighted are those the Growers enter into. 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, that are part of the arrangement to which this Ruling applies. The effect of the agreements listed above is summarised as follows.

14. This arrangement is called the Great Southern Blue Gum Plantations 2000 Project. Growers entering the Project will sublease land from GSMAL in either the south west of Western Australia, in an area known as the 'Great Southern', or within a 150 km radius of the Port of Portland in Victoria, in an area known as the 'Green Triangle Region'. The Growers will also contract with GSMAL, under the Lease and Management Agreement, to have *eucalyptus globulus* (Tasmanian Blue Gum trees) planted on their leased land for the purpose of eventual felling and sale in approximately eleven years.

15. There are 2,000 'Leased Areas' on offer of 0.33 hectares each, at a cost per Leased Area of $3,000, although GSMAL has the right to accept oversubscriptions. A minimum of 1,000 trees per hectare will be planted within the first 13 months, following execution of the Lease and Management Agreements.

16. Possible projected returns for the Project depend on a range of assumptions and GSMAL does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Lease and Management Agreements in question. Based on the examples set out on pages 24 and 25 of the Prospectus, a Grower could expect to achieve compound pre-tax returns of between 6.8% and 10.4%.

Lease and Management Agreement

17. Under the Lease and Management Agreement, Growers enter into an 11 year lease for one or more Leased Areas and contract with GSMAL to establish and maintain the plantation until maturity. Clause 2 of the Lease and Management Agreement grants an interest in the land to the Grower. Growers are not entitled to assign their rights under the Lease and Management Agreement, except in certain circumstances (cl 7). Certificates are issued to Growers. GSMAL

keeps a register of Growers. Growers execute a power of attorney enabling GSMAL to act on their behalf as required (cl 29). Growers may elect to collect their own timber produce (cl 18), or have GSMAL, acting as their agent, sell the timber produce, or process it into woodchips and then sell, on the Grower's behalf, for the best possible commercial price (cl 19). Non-Electing Growers are required to accept the 'Gross Proceeds of Sale' in full satisfaction and discharge of their rights in relation to the Forest Produce (cl 20).

Fees

18. The total fees payable under the Lease and Management Agreement in respect of the period commencing upon execution of the Agreement and ending on 31 July 2000 are $3,000 per Leased Area. However, this includes an amount of $150 for commission services, which is not an allowable deduction.

19. The Independent Forester states, at page 33 of the Prospectus, that 'The activities described in the Lease and Management Agreement are normal to plantation forestry operations. The price per Leased Area adequately covers costs associated with the satisfactory establishment and maintenance including public liability over the life of the project'.

20. The Application Monies will be banked into the GSMAL 2000 Applications Trust Account. These monies will be released from the trust bank account to GSMAL when certain specified criteria have been met (cls 7 and 8 of the Constitution and cl 22 of the Lease and Management Agreement).

21. After 31 July 2000 GSMAL will meet the Project's ongoing costs, other than insurance premiums payable by Growers (cl 23), out of its own funds. In return Growers are charged 3.0% and 2.5% of the Net Harvest Proceeds, respectively, for the services provided and rental of the Leased Area. GSMAL is required to lodge funds in a separate bank account or hold bank backed securities for an amount of the future maintenance costs to be determined by the Independent Forester (cl 11 of the Constitution). This will ensure that sufficient reserve funds will be available, if needed, to meet ongoing maintenance costs of the Project.

Planting

22. During the period commencing on execution of the Lease and Management Agreement (the earliest execution date will be 30 June 1999), and ending on 31 July 2000, GSMAL will be responsible for planting *eucalyptus globulus* on the Leased Areas. From this period on, GSMAL will maintain the trees in accordance with good

silvicultural practice. The services to be provided by GSMAL over the term of the Project are defined in clause 1 of the Agreement. GSMAL will also be responsible for the establishment and maintenance of access roads and fire breaks, and is required to keep the Leased Areas free from vermin. Clause 11.3 of the Agreement provides that the Grower shall have at all times the full right, title and interest in the Forest Produce, and the right to have that produce sold for their benefit.

23. GSMAL will also be responsible for arranging the marketing and sale of either the timber produce or woodchips. When the cubic metre per hectare yield for the Forest equals or exceeds 250 cubic metres per hectare, or no later than 11 years from the Commencement Date, GSMAL will arrange for the harvesting and will notify Electing Growers when and where to collect their produce, and what their proportional shares of the costs of felling are (cl 17.2). GSMAL will provide ongoing reports to the Growers on the progress of the plantation. GSMAL will sub-contract all plantation establishment and maintenance functions to Templegate Services Pty Ltd, a related company.

24. GSMAL will ensure that the Gross Proceeds of Sale are paid into the Proceeds Fund trust bank account. The Growers' proportional shares of the costs of felling and costs of sale, and, if applicable, the costs of chipping, will be paid from the Gross Proceeds of Sale to GSMAL, or the relevant contractor. GSMAL will receive from the Proceeds Fund an amount equal to 2.5% of the Net Proceeds of Sale, as rent, and another amount equal to 3.0%, as remuneration for the services provided after 31 July 2000. These percentages have been calculated to ensure that GSMAL makes a profit in providing these services. The balance of the Net Proceeds of Sale will be held in the Proceeds Fund on trust for the Growers (cl 21).

Finance

25. Growers can choose to fund their investment themselves, borrow from an unassociated lending body or borrow through special finance arrangements offered by TFPL. Two finance options are offered in this last respect:

Option A — interest free
- 10 % deposit (i.e., \$300 per Leased Area)
- 12 equal monthly instalments of \$225 per Leased Area, by periodical debit; or

Option B — principal and interest
- 10% deposit (with a minimum loan principal under this option of \$20,000)

- 48 equal monthly repayments
- interest rate currently 9.5% fixed
- security by mortgage over the Lease and Management Agreement.

26. Under both options GSMAL is to be put in funds by the financier as and when the monthly repayments are due by the Grower. Both options involve full recourse loans and TFPL will pursue legal action against defaulting borrowers. Finance arrangements organised directly by Growers with lenders are outside the arrangement to which this Ruling applies.

Ruling

Section 8-1

27. For the years ending 30 June 1999 and 30 June 2000 section 8-1 of the ITAA 1997 will apply to Growers entering this Project as follows:

i. to allow a deduction of $2,850 of the fee of $3,000 per Leased Area, incurred on execution of the Lease and Management Agreement on 30 June 1999, for the year of income ending 30 June 1999;

ii. to allow a deduction of $2,850 of the fee of $3,000 per Leased Area incurred on execution of the Lease and Management Agreement on 31 January 2000, for the year of income ending 30 June 2000;

iii. to allow a deduction for interest incurred in respect of Option B, during the years ending 30 June 1999 and/or 30 June 2000, for those years.

Section 82KZM

28. The expenditure under the Lease and Management Agreement does not fall within the scope of section 82KZM of the ITAA 1936.

Section 82KL

29. Section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997, as described above.

Part IVA

30. Part IVA does not apply to deny deductions for the expenditure incurred under the Lease and Management Agreement, or to interest on loans taken out under Option B.

Explanations

Section 8-1

31. Consideration of whether lease and management fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

32. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the timber’s sale from the scheme, will constitute gross assessable income in their own right. The generation of ‘business income’ from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

33. Generally, an investor will be carrying on a business of afforestation where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the timber;
- the afforestation activities are carried out on the investor’s behalf; and

- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

34. For this Project Growers have, under the Lease and Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Lease and Management Agreement Growers appoint GSMAL, as Responsible Entity, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. Growers are considered to have control of their investment. The specific cost to the Grower of these services provided in the first thirteen months will total $3,000. Growers may either collect the Forest Produce and arrange for its sale themselves or they have the option of GSMAL arranging marketing and sale in return for a proportion of the sale proceeds.

35. The Lease and Management Agreement gives Growers full right, title and interest in the Forest Produce and the right to have the Forest Produce sold for their benefit (cl 11.3). The Project documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees belong to the Growers in the sense that they have an interest in the land on which they are growing and a profit à prendre in respect of the timber produce, which confers an equitable interest in the trees upon the Grower.

36. Growers have the right to use their Leased Areas for afforestation purposes and to have GSMAL come onto the land to carry out its obligations under the Lease and Management Agreement. The Grower's degree of control over GSMAL, as evidenced by the Agreement, and supplemented by Corporations Law, is sufficient. Under the Project documentation, Growers are entitled to receive regular progress reports on GSMAL's activities. Growers are able to terminate arrangements with GSMAL in certain instances, such as cases of default or neglect. The afforestation activities described in the Lease and Management Agreement are therefore carried out on the Grower's behalf.

37. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. The Independent Forester's report is that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

38. Growers will engage the professional services of a Responsible Entity with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

39. Growers have a continuing interest in the trees from the time they are acquired until harvest. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' afforestation activities will constitute the carrying on of a business.

40. The fees associated with the afforestation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of timber), is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Section 82KZM

41. Under the Lease and Management Agreement the fee of \$3,000 per Leased Area will be incurred on execution of that Agreement. This fee is charged for providing services to a Grower only for a maximum period of 13 months from the execution of the Agreement. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. There is also no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, it can be accepted that no part of the fee of \$3,000 is for GSMAL doing 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Growers of \$3,000 per Leased Area.

Section 82KL

42. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by TFPL to the Grower. The loan is provided on a full recourse basis, and on commercial terms.

Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

43. For Part IVA 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). The Project will be a 'scheme' commencing generally on the date when the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of $2,850 per Leased Area, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

44. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. Further, there are no features of the Project, for example, such as the Lease and Management fee of $2,850 being 'excessive', and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient 'real money' coming into the Responsible Entity's hands, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Interest deductibility

45. Some Growers intend to finance the investment through a loan facility. Whether the resulting interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the Lease and Management fees of $2,850 per Leased Area are deductible. The interest fees will be in respect of a loan to finance the operations - the planting, tending, maintenance and harvesting of the trees - that will continue to be directly connected with the gaining of 'business income' from the Project. These fees will thus also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Detailed contents list

46. Below is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	**1**
Tax law(s)	2
Class of persons	3
Qualifications	5
Date of effect	**9**
Withdrawal	**11**
Arrangement	**12**
Lease and Management Agreement	17
Fees	18
Planting	22
Finance	25
Ruling	**27**
Section 8-1	27
Section 82KZM	28
Section 82KL	29
Part IVA	30
Explanations	**31**
Section 8-1	31
Section 82KZM	41
Section 82KL	42
Part IVA	43
Interest deductibility	45

Commissioner of Taxation
28 April 1999

Previous draft:
No draft issued

Related Rulings/Determinations:
PR 98/1; TR 92/1; TR 97/11;
TR 97/16; TD 93/34

Subject references:
- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- interest expenses
- management fees expenses
- plantation forestry
- primary production
- primary production expenses
- producing assessable income

- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- timber industry

Legislative references:

ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 8-1

Case references:

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