



# ***PR 1999/25 - Income tax: Tasmanian Forest Trust No 7 Project***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 May 1999*



## **Product Ruling**

### **Income tax: Tasmanian Forest Trust No 7 Project**

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#### ***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**

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1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax laws’ 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 Tasmanian Forest Trust No 7 Project’, or just simply as ‘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 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 28) 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.

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## Date of effect

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9. This Ruling applies prospectively from 19 May 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).

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## Withdrawal

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11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2001. 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 change in the arrangement or in the persons' involvement in the arrangement.

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## Arrangement

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

Application for a Product Ruling lodged on behalf of Tasforestry Limited ('Tasforestry') dated 24 December 1998, together with the application's appendices listed below ('the Application'):

- **Appendix A** - information requirements as referred to in Product Ruling PR 98/1;
- **Appendix B** - Draft of the proposed Product Ruling;
- **Appendix C** - a copy of the Prospectus issued by Tasforestry in relation to the Tasmanian Forest Trust No 7 dated 29 October 1998, which incorporates copies of the following agreements ('the Prospectus'):
  - the Management Agreement** to be entered into by Tasforestry and each Grower ('the Management Agreement');
  - the Lease Agreement** to be entered into by Forest Enterprises (Tasmania) Pty Ltd ('FET') and each Grower ('the Lease Agreement'); and
  - the Loan Agreement** to be entered into by Casanda Securities Pty Ltd ('Casanda') and those Growers who wish to borrow from that company in order to finance the payment of fees owing under the Management

Agreement and the Lease Agreement ('the Loan Agreement');

- **Appendix D** - a copy of **the Trust Deed** dated 1 June 1993 constituting the Tasmanian Forest Trusts, Supplemental Deed Number 3 dated 11 April 1996 and Supplemental Deed Number 6 dated 11 September 1998 ('the Trust Deed');
- **Appendix E** - structure diagram illustrating the relationship between the parties and the flow of funds;

letter from Tasforestry's solicitor dated 22 January 1999, together with its annexures;

letter from Tasforestry's solicitor dated 2 March 1999, together with its annexures;

Letter to Tasforestry's solicitor from the Australian Taxation Office dated 16 March 1999;

letter from FET dated 17 March 1999, together with its annexures;

facsimile from FET dated 29 March 1999, together with its annexures

facsimile to FET from the Australian Taxation Office dated 31 March 1999, together with its annexures; and

letter from FET dated 1 April 1999.

**NOTE: certain information received from Tasforestry's solicitor and FET 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 Growers enter into or are otherwise a party to. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which a Grower, or an associate of a Grower will be a party. The effect of these agreements is summarised as follows.

14. This arrangement is called 'the Tasmanian Forest Trust No 7 Project'. Growers participating in the Project will enter into a lease of land in northern Tasmania with FET. The lease will conclude on the first clear fall of any trees to be planted on the relevant land. The Growers will also enter into a Management Agreement with Tasforestry for the establishment and maintenance of a plantation of Tasmanian Shining Gum (*eucalyptus nitens*) trees on this leased land for the purpose of felling and sale in 8 to 13 years. A Trustee, Tasmanian Trustees Limited ('TTL'), is appointed under the Trust

Deed to protect the interests of the Growers in their dealings with the Manager.

15. There is no minimum subscription level required under the Prospectus. There is, however, an option to accept oversubscriptions. The documentation accompanying the Application tells us that there are 4,500 woodlots on offer, each of an area of one third of one hectare. The minimum area of land that can be leased by a Grower under the Project is one woodlot or one third of a hectare. A minimum of 400 trees per woodlot will be planted in the first 13 months following execution of the Lease and Management Agreements. Projected returns for Growers prepared on the basis that they hold 3 woodlots ( i.e., one hectare) are outlined on page 8 of the Prospectus. The Prospectus also sets out the other assumptions underpinning those projected returns and advises that participation in the Project is a long term venture in commercial forestry with all the attendant risks and, therefore, should be considered as speculative. Based on the calculations set out on page 8 of the Prospectus, a Grower could expect to achieve an after tax rate of return of 12.4% per annum with borrowings, 9.1% per annum without borrowings, or a net profit of \$13,451 per holding of 3 woodlots. Growers execute ‘an authority to complete documents’ in favour of Tasforestry at the time they complete and lodge their application form under the Prospectus. Correspondence from FET indicates that there is a seven day ‘cooling-off’ period after Tasforestry receives the completed application, and that upon expiry of the cooling-off period, the application is formally accepted, the documentation completed and copies forwarded to the Grower under formal advice concerning acceptance of their application.

### **Trust Deed**

16. The parties to the Trust Deed are TTL as Trustee, Tasforestry as Manager, and FET as Lessor. By entering into the agreements contemplated by the Trust Deed, the Growers are also made parties to the Trust Deed.

17. The Trust Deed provides that the interest of the Grower in the Trust consists of his / her collective rights under the Lease and Management Agreements and under the Trust Deed (cl 1.9.1). Among other things, it states:

- that a Grower shall be at all times engaged as a principal in the conduct of a commercial forestry undertaking, and shall be Lessee (or sublessee) for the purposes of the Lease and Grower for the purposes of the Management Agreement (cl 1.9.2.1);

- that upon completion of the application form attached to the Prospectus, the Grower forwards the form and the moneys then due under the terms of the Prospectus to Tasforestry, who is then required to lodge those monies, and any subsequent instalments of application monies it receives, with the Trustee (cls 4.1 and 4.12);
- that Growers are permitted to transfer and assign their interests under the Trust Deed by assignments of both the Lease and the Management Agreements, subject to certain limitations (cls 5.1 and 5.2);
- that there is no obligation on Tasforestry to purchase a Grower's interests, but that it undertakes to strive to ensure that there is a secondary market for the interests of Growers, and to introduce any Grower wishing to dispose of his/her interests to a Person willing to acquire the same (cl 5.6);
- that the Gross Proceeds from the sale of the trees are payable by the Manager to the Trustee and are paid into a trust fund administered by the Trustee for dispersal as provided in the Trust Deed (cl 9.1);
- that, after the payment of any amounts then owing to the Trustee and Tasforestry under the Trust Deed, and after deduction and retention of any amounts still owing by a Grower under the Lease and Management Agreements and the Trust Deed, the Trustee is required to pay the balance of the Gross Proceeds from the sale of trees to the Growers ratably according to the number of lots leased by them (cl 9.4);
- that Tasforestry is required to maintain a register of the Investors which shall be available for inspection by the Trustee, Tasforestry, the Auditor and any Grower (cl 10);
- that the Trustee or Tasforestry may at any time, convene a meeting of Growers (cl 12.1);
- that Tasforestry must convene a meeting of Growers upon receipt of a written requisition for a meeting signed by at least 50 Growers or one-tenth in number of the Growers, whichever is the lesser (cls 12.1 and 12.2); and
- that a resolution passed at a meeting of the Growers duly convened and held in accordance with the Trust Deed shall be binding upon all the Growers, and each of the Growers and the Trustee or Tasforestry (as the

case may be) shall be bound to give effect thereto (cl 12).

### **Management Agreement**

18. The parties to the Management Agreement are Tasforestry, as Manager, and the Grower.

19. The Management Agreement recites that the Grower leases the land specified in the Schedule and that the Grower wants Tasforestry to establish a plantation of tree seedlings on the land and to manage and maintain the plantation upon the terms and conditions set out in the agreement.

20. The Management Agreement, among other things, provides:

- that, in consideration of the Grower's payment to Tasforestry of the management fee referred to in clause 12, Tasforestry shall, subject to the reasonable directions of the Grower, provide the Grower with the 'Plantation Establishment Services' and the 'Management Services' described in the agreement (cl 1);
- that 'the Plantation Establishment Services' means the preparation of the land for planting and the planting of the land with trees in accordance with the good silvicultural practice (cl 2), and includes:
  - ◆ the establishment and maintenance of fire breaks on and around the land;
  - ◆ the completion of all preparatory work necessary for the planting of seedlings on the land, including all ploughing and vermin control;
  - ◆ the supply and planting of healthy seedlings to a specified average density per hectare; and
  - ◆ the control of weeds and other vegetation which might inhibit the growth of the seedlings on the land;
- that 'the Management Services' means the tending and rearing of the seedlings and the management and maintenance of the plantation established on the land in accordance with good silvicultural practice (cl 4), and includes:

- ◆ the replanting of any seedlings that die during the first year after planting to 90% of the average planting density;
  - ◆ the general maintenance of the plantation, including control of weeds, suckers, vermin or other pests which may impede the growth of the seedlings;
  - ◆ the application of fertiliser to the land;
  - ◆ the provision of an annual written report to the Grower on the progress of the plantation; and
  - ◆ the provision of advice and assistance generally to the Grower in relation to the thinning and pruning of the plantation and the general management thereof;
- that 'the Plantation Establishment Services' shall be commenced on the Commencement Date specified in the Schedule and Tasforestry shall use its best endeavours to complete 'the Plantation Establishment Services' within 13 months of the Commencement Date (cl 3);
  - that the agreement shall take effect on the Commencement Date and shall, subject to certain specified conditions, remain in force until the date of completion of clear felling of the trees on the land (cl 5);
  - that Tasforestry has the right to determine the appropriate time for the thinning and clear-felling of trees on the land (cl 7);
  - that the Grower irrevocably and unconditionally appoints Tasforestry as his/her sole agent to market and sell the trees growing on the land (cl 8(a));
  - that the Grower will insure the plantation on such terms and conditions as may be recommended by Tasforestry (cl 9(a));
  - that the premiums for the said insurance shall be paid by either:
    - ◆ the Grower (cl 9(a)(i)); or
    - ◆ Tasforestry, on behalf of the Grower, in which case the Grower shall reimburse Tasforestry out of the next thinning or clear fell, together with interest (cl 9(a)(ii));

- that, on the signing of this agreement, the Grower shall pay Tasforestry a Management Fee for the services to be provided pursuant to the agreement in the amount set out in the Schedule (cl 12);
- that the Grower shall pay to Tasforestry a Maintenance Fee calculated in the manner set out in the Schedule on account of the Plantation Establishment Services and all services of a maintenance nature which are to be provided pursuant to this agreement (cl 13);
- that Tasforestry has the right to terminate this agreement and to seek immediate payment of all moneys due under it, notwithstanding and without prejudice to any other action or right it might have, where the Grower commits certain breaches of provisions in either this agreement or the Lease Agreement (cl 14);
- that the 'Plantation Management and Establishment Fee' is:  
 '\$1,570.00/Woodlot plus \$230.00/Woodlot if taken up Option 2 of once only Lease and Management payments...'; and  
 (Schedule, cl 7)
- that the 'Annual Maintenance Fee' (if applicable) is:
  - (a) Annual Maintenance Fee for the first year is incorporated in the Management and Establishment fee of \$1,570 per Woodlot.
  - (b) In the second year the Maintenance/ Management Fee is payable in advance at \$65.00 per Woodlot.
  - (c) Each year thereafter for the balance of the term, the amount of \$30.00 (hereinafter called the 'base amount') is payable in advance and is calculated to include the increase in CPI. ...'

(Schedule, cl 9).

### **Lease Agreement**

21. Growers enter into a Lease Agreement with FET, as Lessor.
22. The Lease Agreement provides that, in consideration for both the payment by the Grower of the rental specified in the agreement's Schedule and the performance by the Grower of covenants set out in the agreement, FET leases the specified land to the Grower for the

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agreed term commencing on the specified Commencement Date (cl 1). Among other things, it states:

- that the Grower covenants to pay the rent (cl 2(a));
- that FET acknowledges the Grower shall have the right to use the land for the establishment of a plantation of trees and may clear and cultivate the land and plant, tend, grow, care for, harvest and sell any form of agricultural crop of trees on the land during the term and any extension thereof (cl 2(b));
- that the Grower has the right to assign or sublet the lease, subject to certain conditions (cl 2(i));
- that the Grower will effect and maintain in full force at all times during the term of this lease a policy of public risk insurance with an insurer approved by FET containing certain specified conditions (cl 2(j)(i));
- that FET will pay the premiums for the said public risk insurance and the Grower will reimburse FET for the premium within 14 days of a demand for payment (cl 2(j)(ii));
- that FET covenants it shall allow the Grower to peaceably hold and enjoy the land during the term of the lease (cl 3(a));
- that, if this lease shall be determined by reason of any breach by the Grower of his/her obligations under the lease, FET shall have the option to purchase all the Grower's right, title and interest in and to all trees for the fair market value of the trees at the time as determined by a Forestry Consultant to be appointed by FET (cl 3(k));
- that the term of the lease is 'from the Commencement Date until the first clear fall of any trees to be planted on the land';

(Schedule to Lease Agreement); and

- that the rental is as follows:

**'OPTION 1** (if applicable)

RENTAL: For the first year of the Term, \$80.00 per Woodlot (hereinafter called 'the base amount') and for the second and each subsequent year a sum calculated as follows:

$$\text{Rental} = \frac{A \times B}{C}$$

where A is the Base Amount; B is the All Group Consumer Price Index weighted average for the eight capital cities...;

C is the Index for the quarter ended 31<sup>st</sup> March 2000...'

'**OPTION2** (if applicable):

ONCE ONLY LEASE PAYMENT of \$800.00 per Woodlot. ...'

(Schedule to Lease Agreement).

### **Fees**

#### 23. Subscription Option 1:

- an initial subscription amount of \$1,650 per woodlot is payable upon application. This amount is made up of \$1,570 per woodlot for the establishment fee and \$80 per woodlot for the first year's rental due under the Lease Agreement;
- annual rental payments of \$80 per woodlot (CPI adjusted) for the second year of the Project and each subsequent year;
- on 31 May 2000, the Grower will be invoiced to pay a forest maintenance fee of \$65 per woodlot;
- on 31 May 2001, the Grower will be invoiced to pay a forest maintenance fee of \$30 per woodlot; and
- the forest maintenance fee for years after 31 May 2001 will be \$30 per woodlot (CPI adjusted) per year.

#### 24. Subscription Option 2:

- a 'once only' payment amount of \$2,600 per woodlot incorporating all plantation preparation, establishment, further maintenance and lease fees for the duration of the project. This amount is made up as follows: \$1,570 for establishment fees, \$230 for prepaid management/maintenance fees, and \$800 for prepaid rental.

### **Finance and the Loan Agreement**

25. The Prospectus outlines a finance option offered by Casanda, a company associated with Tasforestry. If taken up, the loan transaction is evidenced by the execution of a Loan Agreement between Casanda, as lender, and the Grower, as borrower.

26. The Prospectus states finance is available to a maximum of 90% of the amount that must be subscribed for each woodlot. It also specifies the interest rates attaching to the loans offered. They are as follows:

- where the loan term is for one year, the loan is interest-free;
- where the loan term is for two years, the rate of interest is 8% fixed;
- where the loan term is for three years, the rate of interest is 9% fixed; or
- where the loan term is for four years, the rate of interest is 10% fixed.

It also states that a Grower will be required to make monthly repayments, if they select a one or two year loan term, and quarterly repayments, if they select a three or four year loan term.

27. The security for the loan is provided by the assignment to Casanda of the Grower's rights and interest in the Management Agreement and the trees planted under it, and every other document, interest or right held in connection with the cultivation of the trees, including the Lease Agreement (Loan Agreement, cl 7).

28. The loan is provided on a full recourse basis and recovery action will be taken in respect of any outstanding payments.

## Ruling

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### Section 8-1

#### *Subscription Option 1:*

#### ***Where Growers acquire an interest in the Project in the year ending 30 June 1999 and elect Subscription Option 1:***

29. Where a Grower acquires an interest in the Project in the year ending 30 June 1999 and elects Subscription Option 1, the following outgoings will be allowable deductions under section 8-1 in respect of the years of income mentioned below:

#### *Year of income ending 30 June 1999*

- the establishment fee of \$1,570 per woodlot;
- the rental payment of \$80 per woodlot;
- where insurance coverage has been taken out during the year of income ending 30 June 1999 by the Grower

pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;

- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 1999, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 1999;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 1999, the amount representing each Grower's share of the insurance premium paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 1999, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2000*

- the maintenance fee of \$65 per woodlot payable by Growers under the Management Agreement on 31 May 2000;
- the rental payment of \$80 (CPI indexed) per woodlot;
- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for

reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and

- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2001*

- the maintenance fee of \$30 per woodlot payable under by the Growers under the Management Agreement on 31 May 2001;
- the rental payment of \$80 (CPI indexed) per woodlot;
- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ended 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is paid by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

***Where Growers acquire an interest in the Project in the year ending 30 June 2000 and elect Subscription Option 1:***

30. Where a Grower acquires an interest in the Project in the year ending 30 June 2000 and elects Subscription Option 1, the following outgoings will be allowable deductions under section 8-1 in respect of the years of income mentioned below:

*Year of income ending 30 June 2000*

- the establishment fee of \$1,570 per woodlot;
- the rental payment of \$80 per woodlot;
- the maintenance fee of \$65 per woodlot payable by Growers under the Management Agreement on 31 May 2000;
- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2001*

- the maintenance fee of \$30 per woodlot payable by the Growers under the Management Agreement on 31 May 2001;

- the rental payment of \$80 (CPI indexed) per woodlot;
- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses which either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

### ***Subscription Option 2:***

***Where Growers acquire one woodlot only in the Project in the year ending 30 June 1999 and elect Subscription Option 2:***

31. Where a Grower acquires **one woodlot only** in the Project in the year ending 30 June 1999 and elects Subscription Option 2, the following outgoings will be allowable deductions under section 8-1 in the years of income mentioned below:

*Year of income ending 30 June 1999*

- the 'once only' payment of \$2,600;
- where insurance coverage has been taken out during the year of income ending 30 June 1999 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause

9(a)(ii) of the Management Agreement during the year of income ending 30 June 1999, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 1999;

- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 1999, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 1999, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2000*

- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out

to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2001*

- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

***Where Growers acquire one woodlot only in the Project in the year ending 30 June 2000 and elect Subscription Option 2:***

32. Where a Grower acquires **one woodlot only** in the Project in the year ending 30 June 2000 and elects Subscription Option 2, the following outgoings will be allowable deductions under section 8-1 in the years of income mentioned below:

*Year of income ending 30 June 2000*

- the 'once only payment' of \$2,600;
- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower

- pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
  - where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and
  - interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2001*

- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and

- interest expenses which either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

***Where Growers acquire more than one woodlot in the Project in the year ending 30 June 1999 and elect Subscription Option 2:***

33. Where a Grower acquires **more than one woodlot** in the Project in the year ending 30 June 1999 and elects Subscription Option 2, the following outgoings will be allowable deductions under section 8-1 in the years of income mentioned below (although in some circumstances, sub-section 82KZM(1) will limit the amount of deduction otherwise allowable under section 8-1):

*Year of income ending 30 June 1999*

- an amount of \$1,570 per woodlot;
- in respect of prepaid rental, the Grower's deduction entitlement under section 8-1 for the year of income ending 30 June 1999 will be apportioned in line with the formula in subsection 82KZM(1). The numerator in this formula will be the number of days occurring in the period from the date of commencement of the Lease Agreement(s) until 30 June 1999, while the denominator in the formula will be the number of days over a period of ten (10) years. For the year of income ending 30 June 1999, the Grower's deduction will be an amount substantially less than \$80 per woodlot;
- an amount of \$230 per woodlot for prepaid management/maintenance fees, provided the number of woodlots acquired during the year of income is **four or less**;
- where the number of woodlots acquired in the year of income is **five or more**, in respect of the year of income ending 30 June 1999, the Grower has **no** deduction entitlement under section 8-1 for prepaid management/maintenance fees, or for any part of those fees;
- where insurance coverage has been taken out during the year of income ending 30 June 1999 by the Grower pursuant to clause 9(a)(i) of the Management Agreement(s), the amount of the insurance premium;

- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement(s) during the year of income ending 30 June 1999, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 1999;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement(s) and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 1999, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 1999, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2000*

- an amount of \$80 per woodlot, being a proportion of the prepaid rental determined in accordance with the formula in subsection 82KZM(1) of the ITAA 1936;
- the Grower will **not** be entitled to a deduction, in the year of income ending 30 June 2000, under section 8-1 for any part of prepaid management/maintenance fees paid, where the number of woodlots that were acquired is **four or less**;
- where the number of woodlots acquired is **five or more**, the Grower's deduction entitlement under section 8-1 for the year of income ending 30 June 2000 for prepaid management/maintenance fees will be apportioned in line with the formula in subsection 82KZM(1). The numerator in this formula will be the number of days occurring in the period from a date thirteen months after the Date of Commencement of the Management Agreement until 30 June 2000, while the denominator in the formula will be the number of days over a period of ten (10) years. For the year of income ending 30 June 2000, applying the abovementioned formula, Growers will have little or no deduction

entitlement under section 8-1 for prepaid management/maintenance fees;

- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower pursuant to clause 9(a)(i) of the Management Agreement(s), the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement(s) during the year of income ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement(s) and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

### *Year of income ending 30 June 2001*

- an amount of \$80 per woodlot, being a proportion of the prepaid rental determined in accordance with the formula in subsection 82KZM(1);
- the Grower will **not** be entitled to a deduction, in the year of income ending 30 June 2001, under section 8-1 for any part of prepaid management/maintenance fees paid, where the number of woodlots that were acquired is **four or less**;
- where the number of woodlots acquired is **five or more**, the Grower's deduction entitlement under section 8-1 for the year of income ending 30 June 2001 for prepaid management/maintenance fees will be apportioned in line with the formula in subsection 82KZM(1). The numerator in this formula will be the number of days occurring in the period from a date

thirteen months after the Date of Commencement of the Management Agreement until 30 June 2001, while the denominator in the formula will be the number of days over a period of ten (10) years. For the year of income ending 30 June 2001, the Grower's deduction will be an amount less than \$23 per woodlot, unless the Date of Commencement of the Management Agreement is on or before 31 May 1999, in which case the deduction entitlement will be \$23 per woodlot;

- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management(s) Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement(s) during the year of income ending 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement(s) and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

***Where Growers acquire more than one woodlot in the Project in the year ending 30 June 2000 and elect Subscription Option 2:***

34. Where a Grower acquires **more than one woodlot** in the Project in the year ending 30 June 2000 and elects Subscription Option 2, the following outgoings will be allowable deductions under section 8-1 in the years of income mentioned below (although in some circumstances, subsection 82KZM(1) will limit the amount of deduction otherwise allowable under section 8-1):

*Year of income ending 30 June 2000*

- an amount of \$1,570 per woodlot;
- in respect of prepaid rental, the Grower's deduction entitlement under section 8-1 for the year of income ending 30 June 2000 will be apportioned in line with the formula in subsection 82KZM(1). The numerator in this formula will be the number of days occurring in the period from the date of commencement of the Lease Agreement(s) until 30 June 2000, while the denominator in the formula will be the number of days over a period of ten (10) years. For the year of income ending 30 June 2000, the Grower's deduction will be an amount less than \$80 per woodlot, unless the Lease Agreement(s) is entered into on 1 July 1999, in which case the amount of deduction will be \$80 per woodlot;
- an amount of \$230 per woodlot for prepaid management/maintenance fees, provided the number of woodlots acquired during the year of income is **four or less**;
- where the number of woodlots acquired in the year of income is **five or more**, in respect of the year of income ending 30 June 2000, the Grower has **no** deduction entitlement under section 8-1 for prepaid management/maintenance fees, or for any part of those fees;
- where insurance coverage has been taken out during the year of income ending 30 June 2000 by the Grower pursuant to clause 9(a)(i) of the Management Agreement, the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement during the year of income ending 30 June 2000, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2000;
- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2000, the amount representing each Grower's share of the insurance premiums paid by FET; and

- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2000, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

*Year of income ending 30 June 2001*

- an amount of \$80 per woodlot, being a proportion of the prepaid rental determined in accordance with the formula in subsection 82KZM(1);
- the Grower will **not** be entitled to a deduction, in the year of income ending 30 June 2001, under section 8-1 for any part of prepaid management maintenance fees paid, where the number of woodlots that were acquired is **four or less**;
- where the number of woodlots acquired is **five or more**, the Grower's deduction entitlement under section 8-1 for the year of income ending 30 June 2001 for prepaid management/maintenance fees will be apportioned in line with the formula in subsection 82KZM(1). The numerator in this formula will be the number of days occurring in the period from a date thirteen months after the Date of Commencement of the Management Agreement until 30 June 2001, while the denominator in the formula will be the number of days over a period of ten (10) years. For the year of income ending 30 June 2001, applying the abovementioned formula, Growers will have little or no deduction entitlement under section 8-1 for prepaid management/maintenance fees;
- where insurance coverage has been taken out during the year of income ending 30 June 2001 by the Grower pursuant to clause 9(a)(i) of the Management Agreement(s), the amount of the insurance premium;
- where insurance coverage has been taken out by Tasforestry on behalf of the Grower pursuant to clause 9(a)(ii) of the Management Agreement(s) during the year of income ending 30 June 2001, an amount representing the Grower's share of the total insurance premium paid by Tasforestry during the year of income ending 30 June 2001;

- where insurance coverage has been taken out by FET on behalf of Growers pursuant to clause 2(j) of the Lease Agreement(s) and FET has made a demand for reimbursement from the Growers during the year of income ending 30 June 2001, the amount representing each Grower's share of the insurance premiums paid by FET; and
- interest expenses that either have been paid or have fallen due for payment during the year of income ending 30 June 2001, where the interest is incurred by the Grower in respect of a loan from Casanda taken out to finance the payment of fees owing under the Management and Lease Agreements.

## **Section 82KL**

35. Section 82KL will not apply to deny deductions to Growers that would otherwise be allowable under section 8-1, or a combination of both section 8-1 and subsection 82KZM(1), for expenditure incurred in relation to the Project, or for interest on loans taken out to finance expenditure in relation to the Project.

## **Part IVA**

36. Part IVA will not apply to deny deductions otherwise allowable under either section 8-1, or a combination of section 8-1 and subsection 82KZM(1), in respect of expenditure on establishment fees, rental and management/maintenance fees incurred in relation to the Project, or for interest on loans taken out to finance the aforementioned expenditure in relation to the Project.

## **Explanations**

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### **Section 8-1**

#### ***Subscription Options 1 and 2:***

37. Consideration of whether fees payable under the Management Agreement and Lease Agreement 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 that a taxpayer contractually commits himself/herself 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 in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

38. 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 sale of the timber 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.

39. 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.

40. For this Project, Growers have, under the Lease 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 Management Agreement Growers appoint Tasforestry, as Manager, to provide services such as planting, cultivating, tending, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. Growers control their investment. On behalf of Growers, Tasforestry will undertake the harvesting, marketing and sale of the timber.

41. The Lease Agreement gives Growers more than a chattel interest in the wood on harvest. The Project documentation contemplates Growers will have an ongoing interest in the growing

trees: a leasehold interest usually confers on an investor an identifiable interest in specific trees in the area covered by the lease.

42. Growers have the right to use the land in question for afforestation purposes and to have Tasforestry come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over Tasforestry, as evidenced by the Trust Deed, the Lease and Management Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports (including annual written reports) on Tasforestry's activities. Growers are able to terminate arrangements with Tasforestry in certain instances, such as cases of default or neglect. The afforestation activities described in the Management Agreement are carried out on the Growers' behalf.

43. 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. The Independent Forester's report is that 'growth and yields seem assured for investors'. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return an 'after 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.

44. Growers will engage the professional services of a manager 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.

45. 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.

46. 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 wood) 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*****Subscription Option 1:***

47. The establishment fee of \$ \$1,570 per woodlot will be incurred on execution of the Management Agreement. It is charged for providing a number of specified services to Growers which will be fully provided within the period of 13 months from the Commencement Date of the Agreement. For the purposes of this Ruling, it is accepted that no part of the establishment fee of \$1,570 is for Tasforestry doing ‘things’ that are not to be wholly done within 13 months of the fee being incurred. The basic precondition for section 82KZM’s operation is not satisfied and it will not apply to the expenditure by Growers of \$1,570 per woodlot.

***Subscription Option 2:***

48. The ‘once-only’ payment of \$2,600 per woodlot is composed as follows:

- \$1,570 for plantation establishment fees, being for services to be provided within the first thirteen months after the Commencement Date of the Management Agreement, which date would also usually be the date on which the Grower acquired his/her interest(s) in the Project;
- \$800 for prepaid rental for the duration of the Project; and
- \$230 for prepaid Management/Maintenance Fees in respect of services to be provided over a period commencing thirteen (13) months after the Commencement Date of the Management Agreement and concluding upon the clear-felling of the plantation.

49. For the purposes of this Ruling, it is accepted that no part of the establishment fee of \$1,570 per woodlot is for Tasforestry doing ‘things’ that are not to be wholly done within 13 months of the fee of \$1,570 being incurred. The basic precondition for section 82KZM’s operation is not satisfied and it will not apply to the expenditure by Growers of \$1,570 in establishment fees per woodlot.

50. The remaining components of the ‘once-only’ amount of \$2,600, namely, the \$800 pre-paid rental and the \$230 pre-paid Management/Maintenance Fees, relate to payments for services which are to be provided over a period that exceeds 13 months from the date they are incurred.

51. The \$800 prepaid rental amount per woodlot relates to the lease of the land on which the trees will be grown from the date the

Lease Agreement takes effect until the date of clearfell in approximately 13 years. Where a Grower acquires only one woodlot and incurs a liability to pay only \$800 in prepaid rental, subsection 82KZM(1) has no application because the rental amount incurred is excluded expenditure under the definition in subsection 82KZL(1), being an amount of expenditure less than \$1,000. Where, however, the Grower acquires more than one woodlot, he/she will incur expenditure in relation to prepaid rental in excess of the excluded expenditure threshold of \$1,000 and, consequently, subsection 82KZM(1) will have an application.

52. Where sub-section 82KZM(1) applies, it requires that the deduction that would be otherwise be allowable in respect of the expenditure under section 8-1 be apportioned over the period during which the services are to be performed or ten years, whichever is the lesser, the proportion allowable in each year being ascertained in accordance with the formula set out in that subsection, namely:

$$\frac{\textit{Period in year}}{\textit{Eligible Service Period}}$$

53. In the context of this Project, the numerator in the above formula, '*Period in year*', means the number of days of the lease term that occur in the year of income, while the denominator in the above formula, '*Eligible Service Period*', means the number of days over the term of the lease or ten (10) years, whichever is the lesser. For the purposes of the Project, the '*eligible service period*' is the number of days in a period of ten (10) years.

54. Thus, in respect of the \$800 prepaid rental component for Growers who acquire interests during the year of income ending 30 June 1999 under Subscription Option 2, after applying the abovementioned formula, the deduction in respect of the year of income ending 30 June 1999 will be an amount substantially less than \$80 per woodlot determined according to the formula set out above. If the Grower, however, acquires his/her interest(s) in the Project during the year of income ending 30 June 2000, his/her deduction for that year of income will be an amount less than \$80 per woodlot, unless the Lease Agreement(s) is entered into on 1 July 1999, in which case the amount of deduction will be \$80 per woodlot. For the years of income immediately after the year in which the Grower acquired his/her interest(s) in the Project, the amount of deduction for prepaid rental, after applying the formula in subsection 82KZM(1), will be \$80 per woodlot.

55. The \$230 prepaid management/maintenance fee amount per woodlot relates to the provision of services over a period commencing thirteen (13) months after the Commencement Date of the Management Agreement and concluding upon the clear-felling of the plantation in approximately 13 years. As was mentioned at paragraph

50, this amount per woodlot is clearly expenditure incurred in return for the doing of services under the Management Agreement that are not to be wholly done within thirteen months after fee is incurred. The application of subsection 82KZM(1) must, therefore, be considered.

56. Where a Grower acquires four or fewer woodlots, he/she will incur a liability to pay prepaid management/maintenance fees in respect of those woodlots totalling an amount less than \$1,000. In these circumstances, subsection 82KZM(1) will have no application because the prepaid management/maintenance fee amount(s) incurred will be excluded expenditure under the definition in subsection 82KZL(1), being an amount of expenditure less than \$1,000. Accordingly, in these circumstances, the Grower will be entitled to a deduction of \$230 per woodlot in the year of income in which the interest(s) in the Project are acquired.

57. Where, however, the Grower acquires five or more woodlots, he/she will incur expenditure in relation to prepaid management/maintenance fees in excess of the excluded expenditure threshold of \$1,000 and, consequently, subsection 82KZM(1) will have an application and the Grower's deduction entitlement will have to be calculated by reference to the formula in subsection 82 KZM(1).

58. In the context of this Project, the numerator in the formula in subsection 82KZM(1), '*Period in year*', means the number of days occurring in the period from a date thirteen months after the Date of Commencement of the Management Agreement until 30 June of the year of income, while the denominator in the above formula, '*Eligible Service Period*', means the number of days during the term of the Management Agreement from the time when the services to be provided in return for the prepaid management/maintenance fees commence to be performed until the time when the services to be provided in return for the prepaid management/maintenance fees cease to be performed, or ten (10) years, whichever is the lesser. For the purposes of the Project, the '*eligible service period*' is the number of days in the period of ten (10) years.

59. Thus, in respect of the \$230 per woodlot prepaid management/maintenance fee component under Subscription Option 2 paid during the year of income ending 30 June 1999, where the Grower acquires five or more woodlots, he/she will have no deduction entitlement in respect of the year of income ending 30 June 1999 because, under the terms of subsection 82KZM(1), an entitlement to a deduction only arises where there is an overlap between the '*eligible service period*' and the year of income in which the deduction is to be allowed. In the circumstances of this Project, there is no such overlap as the '*eligible service period*' in relation to the prepaid management/maintenance expenses, given the terms of the Management Agreement and the

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Prospectus, does not commence until a date thirteen months after the Date of Commencement of the Management Agreement - a date that will occur well after the conclusion of the year of income ending 30 June 1999, and depending on the Date of Commencement of the Management Agreement, possibly after the conclusion of the year of income ending 30 June 2000.

60. Where the Grower acquires interests in five or more woodlots in the Project during the year of income ending 30 June 1999, his/her deduction entitlements in respect of prepaid management/maintenance fees for the years ending 30 June 2000 and 30 June 2001 will also stand to be determined by the formula in subsection 82KZM(1). He/she will be entitled to little or no deduction under the formula for the year ending 30 June 2000 and, subject to a proviso to follow, will have a deduction entitlement for an amount of less than \$23 per woodlot for the year ending 30 June 2001. The proviso is, that if the Date of Commencement of the Management Agreement is on or before 31 May 1999, the Grower's deduction entitlement for the year ending 30 June 2001 will be \$23 per woodlot.

61. The rationale for the apportionments referred to paragraph 60 is also to be found in the fact that apportioned deductions under subsection 82KZM(1) can only be allowed where the year of income overlaps with the whole or part of the eligible service period, and even when this happens, unless the year of income overlaps with the whole of the eligible service period, the apportioned deduction entitlement is further reduced under the formula to allow a deduction only for the portion of the year of income over which management/maintenance services are to be provided. As has been explained in paragraph 59, the eligible service period in relation to the provision of the services to which the prepaid management/maintenance fees relate does not commence until a date thirteen months after the Date of Commencement of the Management Agreement. In the context of the Project, then, if the Date of Commencement of the Management Agreement is after 31 May 1999, there will be no entitlement to a deduction in respect of the prepaid management/maintenance fees for the year of income ending 30 June 2000 because, under the terms of the Management Agreement, the services to which the prepaid management/maintenance fees relate do not commence to be performed until after the conclusion of the year of income ending 30 June 2000. If the said services do not commence to be performed on or about 1 July 2000, there will be a deduction entitlement of less than \$23 per woodlot for the year ending 30 June 2001 for similar reasons.

62. Where the Grower acquires interests in five or more woodlots in the Project during the year of income ending 30 June 2000 and elects Subscription Option 2, his/her deduction entitlements in respect of prepaid management /maintenance fees for the years ending 30

June 2000 and 30 June 2001 also stand to be determined according to the principles outlined at paragraphs 59 to 61.

### **Section 82KL**

63. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by Casanda to the Grower, which if taken out for a term of one year will be interest-free, and if taken out for 2,3 or 4 year terms, will be at commercial rates of interest. The loan is provided on a full recourse basis. In relation to the one year interest-free loan, the Grower will incur no 'relevant expenditure', as that expression is defined in subsection 82KH(1), and consequently, the provisions of section 82KL will not be triggered. In relation to the two, three or four year loans, either insufficient or no 'additional benefits' will be provided to trigger the application of section 82KL. Section 82KL will not apply to deny interest deductions otherwise allowable under section 8-1.

64. Section 82KL will also not apply to deny deductions otherwise allowable under either section 8-1, or a combination of section 8-1 and subsection 82KZM(1), for establishment fees, prepaid rental or prepaid management/maintenance fees.

### **Part IVA**

65. 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 Tasmanian Forest No 7 Project will be a 'scheme'. It commenced in the period leading up to the issue of the Prospectus on 29 October 1998. The Growers will obtain, for example, 'tax benefits' from entering into the scheme, in the form of deductions for the amounts referred to in paragraphs 29 to 34 above, allowable under either section 8-1, or a combination of section 8-1 and subsection 82KZM(1), 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.

66. 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 Management Fee or the Lease fees being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, 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.

**Insurance premiums**

67. Under the Management Agreement, if Tasforestry decides that insurance should be taken out in relation to a plantation, Growers must take it out on the terms and conditions recommended by Tasforestry. The same agreement provides two alternative ways for Growers to pay for such insurance coverage. First, it provides an option whereby the Grower must pay the premium for the insurance coverage within fourteen days of a demand for payment being made (cl 9(a)(i)). Secondly, and in the alternative, Tasforestry may pay the premium on behalf of the Grower, in which case the Grower must reimburse Tasforestry 'out of the next thinning or clear-fell, together with interest hereon at a rate per annum being four percentage points higher than that charged by Commonwealth Bank on indicator lending rate' (cl 9(a)(ii)).

68. Under the Lease Agreement, the Grower is required to take out public risk insurance for an amount of at least \$5 million with an insurer approved by FET. Furthermore, FET makes the payment of the premium and the Grower has fourteen days, after receipt of a demand for payment, to refund the amount of his/her share of the premium to FET.

69. Any insurance recoveries under the above policies will be assessable, thus insurance premiums paid will have a sufficient connection with the gaining or producing of assessable income. The expenditure is required under both the Management Agreement and the Lease Agreement, and is relevant and incidental to the operations which more directly gain or produce the assessable income. These insurance premiums will, thus, have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them. The insurance premiums will be deductible under section 8-1, but as paragraphs 67 and 68 set out three different scenarios under which a Grower has obligations under the Management and Lease Agreements to pay for insurance coverage, the question becomes 'when does the Grower become entitled to claim a deduction for fulfilling those obligations?'. Taxation Rulings TR 94/26 and TR 97/7 set out the Australian Taxation Office's interpretation of the law relating to the meaning of the term 'incurred' and 'the timing of deductions', and it will be those interpretations that will be applied in answering the question posed in the preceding sentence.

70. In relation to insurance coverage taken out under the circumstances contemplated by clause 9(a)(i) of the Management Agreement and on the assumption this it is the Grower that actually takes out the insurance policy, then the Grower will be entitled to a

deduction for insurance premiums in the year of income in which he/she takes out the policy and pays the premium.

71. With respect to insurance coverage taken out by Tasforestry on behalf of a Grower under circumstances contemplated by clause 9(a)(ii) of the Management Agreement, the Grower will be entitled to a deduction for his/her share of the total insurance premium paid by Tasforestry in the year of income in which takes out the insurance cover and pays the premium. This entitlement arises because, at the time that Tasforestry takes out the insurance coverage on behalf of Growers, each Grower will then have a presently existing liability under the terms of the Management Agreement to reimburse Tasforestry, albeit at a future time (i.e., at the time of a thinning or clear-felling), for his/her share of that insurance premium.

72. Finally, where FET has taken out insurance coverage pursuant to clause 2(j) of the Lease Agreement on behalf of Growers, the Grower will be entitled to a deduction for his/her share of the total insurance premium paid by FET, at the time when FET actually makes a demand on the Grower for reimbursement of that amount. It is not until that demand for reimbursement is received that the liability becomes more than merely pending, threatened or expected.

### **Interest deductibility**

73. Some Growers intend to finance their investment in the Project through a loan facility offered by Casanda. Whether the interest expenses are deductible under section 8-1 depends on the same reasoning as that applied to whether the establishment fees, the rental amounts or the management/maintenance fees will be deductible. The interest expenses incurred in the years ended 30 June 1999, 2000 and 2001 will be in respect of a loan to finance the operations - the tending, maintenance and harvesting of the trees, and the lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. These expenditures 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**

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

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**Commissioner of Taxation**

 19 May 1999
 

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<i>Previous draft:</i>	- commencement of business
No draft issued	- fee expenses
	- forestry
<i>Related Rulings/Determinations:</i>	- interest expenses
PR 98/1; TR 92/1; TR 94/26;	- management fees expenses
TR 97/7; TR 97/11; TR 97/20;	- plantation forestry
TD 93/34	- primary production
	- primary production expenses
<i>Subject references:</i>	- producing assessable income
- afforestation expenses	- product rulings
- carrying on a business	- public rulings
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- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- timber industry
- ITAA36 82KZL
- ITAA36 82KZM
- ITAA36 82KZM(1)
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 8-1

*Legislative references:*

- ITAA36 82KH
- ITAA36 82KL

*Case references:*

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