



PR 1999/3 - Income tax: The Australian Blue Gum Trust No 8

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Product Ruling

Income tax: The Australian Blue Gum Trust No 8

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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 Ruling is about

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 Australian Blue Gum Trust No 8, 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, 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 expresses no opinion on whether the fees charged 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 22) 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

9. This Ruling applies prospectively from **10 February 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 1999. 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 for Australian Blue Gum Trust No 8;
- **Lease and Management Agreement** between each Grower and Australian Blue Gum Management Limited ('ABGM'), as 'Manager', Forest Estates No 2 Pty Ltd ('FE2'), as 'Lessor', and Charters Services Pty Ltd as Trustee of the Project ('the Trustee');
- 'Memorandum of Common Provisions referred to in Leases and Sub-Leases granted by Forest Estates No 2 Pty Ltd as Lessor or Sub-Lessor pursuant to the Trust';
- 'Finance Package' prepared by Western Forest Finance Pty Ltd ('WFF') for the Project; and
- Letter from Arthur Andersen dated 16 November 1998, including 'Australian Blue Gum Trust No 8 Trust Deed', dated 5 March 1998, and 'Technical Advice Agreement', dated 5 March 1998.

Note: certain information received from Arthur Andersen 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. The effect of these agreements is summarised as follows.

14. This arrangement is called the Australian Blue Gum Trust No 8. Growers entering into the Project will lease land from FE2 in either south western Western Australia, or in that area of south eastern South Australia and western Victoria, known as 'the Green Triangle'. The growers will enter into a Lease and Management Agreement with ABGM, FE2 and the Trustee to have Tasmanian Blue Gum (*eucalyptus globulus*) seedlings planted on leased land for the purpose of eventual felling and sale in 8 to 12 years.

15. There are a number of Leased Areas on offer of 0.4 hectare each, at an initial cost of \$3,300 per area, payable on execution of the Lease and Management Agreement. There is no minimum subscription level. Seedling stocking rate will be not less than 400 trees per Leased Area, and planting is to occur within 13 months of acceptance of a Grower into the project. The projected returns for Growers are outlined on page 14 of the Prospectus. The projected returns depend on a range of assumptions. A Grower could expect, on the basis of the scenarios set out on page 14, to achieve an internal rate of return before tax, ranging from 4.33% to 12.6%.

Lease and Management Agreement

16. Growers contract with ABGM under the Lease and Management Agreement, to establish and maintain the plantation until maturity (cl 5.1) and, if they choose to become a 'Participating Grower', to have ABGM harvest and sell the wood on their behalf (cls 11.3 to 11.9). The services provided include acquiring and planting seeds or seedlings on behalf of Growers, establishing and maintaining the trees, and maintaining firebreaks and access roads (cl 6.2). The services provided under clause 6.2 must be provided within 13 months of execution of the agreement. Growers execute a power of attorney enabling ABGM to act on their behalf in executing the agreement. Subsequent management (and lease) fees are met through the Grower agreeing to pay a 'royalty' to ABGM, being, for a Participating Grower, 5% of the Grower's 'Proportionate Share' of sale proceeds (cl 9.1). Growers are not entitled to assign their rights under the Lease and Management Agreement except in certain circumstances (cl 14.4).

17. Under Part 4 of the agreement, a Grower is granted an interest in the relevant land. Only the lease for the 'Initial Period', being 13

months from the date of execution of the agreement, is payable on application to enter the project. Clause 4.3(c) confers a right on the Grower to harvest, market and sell the timber grown on their Leased Area, but not any coppice after the first harvest.

Fees

18. The Management fee for services provided in the 'Initial Period' is \$3,230 per Leased Area and is for plantation preparation and establishment costs. The rental fee for the 'Initial Period' is \$70 per Leased Area.

19. The Trustee is appointed to receive application moneys and ensure those moneys are applied in accordance with the agreements. The Manager will pay the Trustee's fees.

20. ABGM has advised that prior to 31 July 1999 Growers need not insure their trees because it has guaranteed a survival rate of 80% of seedlings up to that date. ABGM can organise participation of Growers in a Plantation Insurance Scheme and will notify them of the availability, cost and procedure for insuring their trees (page 17 of the Prospectus).

Planting

21. The Leased Areas will be planted within 13 months of a Grower executing the Lease and Management Agreement. ABGM will maintain the trees in accordance with good silvicultural practice. It will provide ongoing reports to the Growers on the progress of the plantations.

Finance

22. Two finance options are offered by Western Forest Finance Pty Ltd ('WFF'), a company associated with ABGM. Under the first, finance is available for a period of 12 months to a maximum of \$3,025 per \$3,300 charged for each Leased Area. The interest rate is nil. The loan is repayable by equal monthly instalments of principal and is provided on a full recourse basis. Legal action will be taken over any outstanding repayments. Under the second, finance is made available on a principal and interest basis for a term of 3 years, but only where a minimum of 5 Leased Areas are applied for. A minimum deposit of 30% per \$3,300 charged for each Leased Area, is required. The interest rate is 9.5% fixed for the term of the loan, and the loan is to be paid off by 36 equal monthly instalments of principal and interest. Finance arrangements organised directly by a Grower with a lender are outside the arrangement to which this Ruling applies.

Ruling

Section 8-1

23. For the year ending 30 June 1999, section 8-1 of the ITAA 1997 will apply to Growers entering into this Project as follows:

- i. the Rent and Management fees of \$3,300 per Leased Area, incurred by a Grower on execution of the Lease and Management Agreement on or before 30 June 1999, will be an allowable deduction; and
- ii. where a Grower borrows funds in order to fund the obligation to pay the Rent and Management fees and incurs interest on such borrowings on or before 30 June 1999, that interest will be an allowable deduction.

Section 82KZM

24. The expenditure by Growers does not fall within the scope of section 82KZM of the ITAA 1936.

Section 82KL

25. Section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA

26. Part IVA does not apply to deny deductions for the expenditure by Growers or interest on any loans taken out to fund payment of their expenditure.

Explanations

Section 8-1

27. Consideration of whether Rent 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 himself 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.

28. 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.

29. 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.

30. 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 ABGM, as Manager, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers control their investment.

31. The Lease and Management Agreement give Growers more than a chattel interest in the timber on harvest. The Project documentation contemplates Growers will have an ongoing interest in

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the growing trees - the trees are the Growers' property and Growers have a legal interest in the land, being the lease itself.

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

33. The general indicators of a business, as developed 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. 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.

34. 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.

35. 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.

36. 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

37. Under the Lease and Management Agreement the fees of \$3,300 per Leased Area will be incurred on execution of that Agreement. This fee is charged for providing services to a Grower only for the period of 13 months from the execution of the Agreement. For this Ruling's purposes 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. The fee is expressly stated to be for a number of specified services. There is 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 no part of the fee of \$3,300 is for ABGM doing 'things' that are not to be wholly done within 13 months of the fee of \$3,300 being incurred. On this basis, the basic precondition for section 82KZM's operation is not satisfied and it will not apply to the expenditure by Growers of \$3,300 per Leased Area.

Section 82KL

38. 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 WFF to the Grower. The loan is provided on a full recourse basis. 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

39. 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 when the Prospectus is issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of \$3,300 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 the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

40. 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 rent and management fee of \$3,300 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.

Interest deductibility

41. Some Growers intend to finance the investment through a loan facility. Whether the interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the Rent and Management fees of \$3,300 per Leased Area to be incurred in the year ended June 1999 will be deductible. The interest fees incurred in the years ended 30 June 1999, 30 June 2000 and 30 June 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 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.

Insurance deductibility

42. Insurance may be arranged to insure the Leased Areas against fire and other risks. Any insurance recovery will be assessable. The insurance premiums will thus have a sufficient connection with the gaining of assessable income from the Project. No capital, private or domestic component is identifiable in respect of them.

Detailed contents list

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Commissioner of Taxation

10 February 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:

- ITAA36 82KL
- ITAA36 82KZM
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 8-1

Case references:

ATO References:

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