



PR 1999/77 - Income tax: Coonawarra Blue Gums 1999 Project

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Product Ruling

Income tax: Coonawarra Blue Gums 1999 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

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 Coonawarra Blue Gums 1999 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 the relevant provisions of 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 25**) 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 23 June 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 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.

Arrangement

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

- application for a Product Ruling, dated 29 March 1999;
- The Coonawarra Blue Gums 1999 Project Information Memorandum No 2, dated 16 March 1999;
- **Lease Agreement** between Coonawarra Blue Gums Pty Ltd ('CBGL'), the Lessor and the Grower as provided on 29 March 1999, undated;
- **Plantation Management Agreement** between CBGL and the Grower as provided on 9 June 1999, undated;
- Loan Agreement between the Lender, FF Nominees Pty Ltd as trustee for the Fairthorne Family Trust and the Borrower, Coonawarra Forestry Land Holdings Pty Ltd as trustee for the Fairthorne Family No 3 Trust, undated;
- **Loan Agreement** between the Grower and the Lender, Coonawarra Forestry Land Holdings Pty Ltd (CFLH) as provided on 9 June 1999, undated;
- Taxation Opinion of Thomson Playford dated 9 June 1999; and

- letters from Thomson Playford, the taxation consultant of CBG dated 5 May 1999, 25 May 1999, 26 May 1999, 28 May 1999 and 9 June 1999.

NOTE: certain information received from Thomson Playford and Coonawarra Blue Gums Pty Ltd 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. There are no other agreements, whether formal or informal, and whether or not legally enforceable, that a Grower, or any associate of the Grower, will be a party to. The effect of these agreements is summarised as follows.

14. This arrangement is called The Coonawarra Blue Gums 1999 Project. Growers participating in the Project will commit to plant 100 hectares of trees over one or two years depending on which one of two options they chose. Growers will enter into a Plantation Management Agreement and one or two Lease Agreements to lease a 100 hectare area of land ('the Allotment') from CBGL. Under the Plantation Management Agreement the Growers have Tasmanian blue gum trees (*eucalyptus globulus*) planted on the Allotment for the purpose of eventual felling and sale. The Allotment is located in the Green Triangle plantation region within a radius of 200 kilometres of the port of Portland.

15. There is no minimum amount that must be raised under the Information Memorandum. A minimum of 1,250 trees per hectare will be planted in the first 13 months following execution of the Lease and Plantation Management Agreements. Possible projected returns and cash flows for Growers are outlined on pages 18, 19, 26 to 34 of the Information Memorandum. The projected returns depend on a range of assumptions and CBGL does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Lease and Plantation Management Agreements being offered pursuant to the Information Memorandum. A Grower could expect to achieve a before tax annual return of 24%. Growers execute a power of attorney enabling CBGL to act on their behalf as required, when they make an application for the Allotment.

Plantation Management Agreement

16. A Plantation Management Agreement is entered into between CBGL and the Grower for the Allotment. The term of the Agreement is until 30 June 2013 (under 'Option 1') or 30 June 2014 (under 'Option 3') unless terminated earlier in accordance with the

Agreement (cl 3). Growers contract with CBGL to establish and maintain the Trees until maturity for a Plantation Establishment Fee of \$292,000 and an annual Maintenance Fee of \$70 per hectare (\$7,000 / 100 ha) increased by 3% per annum (cls 7, 8). CBGL will provide the maintenance services specified in clause 5.3. CBGL will harvest and sell the Trees on the Growers' behalf in consideration of the Grower paying a Harvest Fee (cl 6). CBGL will keep a public risk insurance policy (cl 5.3.11).

Lease Agreement

17. The lease is 14 years from 30 June 1999 at a cost of \$155 per hectare per annum (\$15,500 / 100 ha) adjusted from and including the year ended 30 June 2001 by 3% per annum.

18. The permitted use for the Allotment is the establishment, maintenance and harvesting of a plantation of Trees (cl 2.6). If the lessee defaults or breaches any conditions, the lessor can take possession of the Land (cl 4.1). If 40% or more of the Trees are destroyed the Lease Agreement may be terminated. The Grower may, at the Lessor's discretion and the Grower's cost, be required to restore the land to its previous condition immediately prior to the commencement of the Lease (cl 4.5.2). The Lessor retains the right to the Coppice (cl 5).

Fees

19. The fees payable under the Options of the Lease and Plantation Management Agreements are:

- Plantation Establishment Fee of \$292,000;
- Maintenance Fee of \$70 per hectare p.a. (\$7,000 per 100 ha p.a.) adjusted upwards by 3% p.a. in advance;
- Lease Rental Fee of \$155 per hectare p.a. (\$15,500 per 100 ha p.a.) adjusted upwards by 3% p.a. in advance;
- Harvest Fee of 5% of the net proceeds from the sale of woodchip; and
- Harvest related expenditure in the year of income the expenditure is incurred by the Manager.

20. There are 2 options for the payment of the Plantation Establishment Fee. Depending on the option chosen, the Grower may choose either to plant the full 100 hectares in the year 2000, or to enter into two Lease Agreements and plant 50 hectares in 2000, to be followed by a further 50 hectares in 2001:

- Under 'Option 1' the Plantation Establishment Fee of \$292,000 is payable on execution of the Management Agreement. (cl 7.1)
- Under 'Option 3' the Plantation Establishment Fee of \$292,000 is payable in 2 instalments - \$146,000 on execution of the Agreement and \$146,000 on the first anniversary of the date of the Agreement (cl 8.1.1).

Finance

21. Growers have the option of entering into a loan agreement with CFLH. The loan will be on commercial terms. Growers will be required to pay a commercial interest rate. The loan is not limited in recourse and CFLH is granted a lien over the Grower's interest in the blue gum trees by way of security (cl 8 Loan Agreement).

22. If a Grower elects to participate in the Project under 'Option 1' and enters into the Loan Agreement they will be required to pay \$141,620 of the Plantation Establishment Fee from their own resources or by external finance and the balance of \$150,380 will be loaned by CFLH to the Grower. The Grower will direct CFLH to pay the loan funds directly to CBGL in satisfaction of the Grower's obligation to pay the Plantation Establishment Fee (cl 2.2). The loan will be repaid in four equal six monthly instalments of \$37,595 over the first two years of the Project (Item 4 of the Schedule to the Loan Agreement).

23. If a Grower elects to participate in the Project under 'Option 3' and enters into the Loan Agreement they will be required to pay \$70,810 of the Plantation Establishment Fee from their own resources or by external finance. CFLH will lend the Grower \$75,190 in each of the first two years of the Project. The Grower will direct CFLH to pay the loan funds directly to CBGL in satisfaction of the Grower's obligation to pay the plantation establishment fee (cl 2.2). The loan will be repaid in two six monthly instalments of \$18,798, two six monthly instalments of \$18,797 and two six monthly instalments of \$37,595 with the first repayment to be made on or before 31 December 1999 (Item 5 of the Schedule to the Loan Agreement). The loan will be fully repaid in the first three years of the Project.

24. Interest on the loans will be charged at a rate of 7.5% per annum and shall be due and payable six monthly in arrears.

25. CFLH will obtain funds to lend to Growers from FF Nominees Pty Ltd as trustee for the Fairthorne Family Trust. CFLH will have full recourse to the Borrower's assets should the Borrower (Grower) default, and it will pursue appropriate legal action against defaulting Growers. Funds borrowed from CFLH will be paid direct to CBGL.

No part of the amount borrowed will go back on deposit with CFLH or any associate of CFLH.

Insurance

26. The Grower may insure the trees against loss by fire and peril. The cost of this insurance will be borne by the Grower. If required, CBGL will assist the Grower with the arrangement of fire and peril insurance cover (cl 11.1). There will be no fee for this assistance.

Ruling

Section 8-1

27. For the year ended 30 June 1999 section 8-1 will apply to Growers entering into this Project as follows:

- the Plantation Establishment Fee of \$292,000 per 100 Hectares incurred by a Grower on execution of the Plantation Management Agreement on or before 30 June 1999 under **'Option 1'** will be an allowable deduction; or
- the Plantation Establishment Fee of \$146,000 per 50 Hectares incurred by a Grower on execution of the Plantation Management Agreement on or before 30 June 1999 under **'Option 3'** will be an allowable deduction;
- where a Grower borrows funds from CFLH in order to fund their obligation to pay the Plantation Management Fees, and incurs interest on such borrowings on or before the end of that respective year, that interest will be an allowable deduction.

28. For the year ended 30 June 2000 section 8-1 will apply to Growers entering into this Project as follows:

- the Plantation Establishment Fee of \$146,000 per 50 Hectares incurred by a Grower under the Plantation Management Agreement on or before 30 June 2000 under **'Option 3'** will be an allowable deduction.

29. For each of the years ending 30 June 2000 and 30 June 2001 section 8-1 will apply to Growers entering into this Project as follows:

- annual maintenance of \$70 per Hectare, indexed, incurred by a Grower on or before 30 June 2000 and 30 June 2001 will be an allowable deduction;

- annual lease rental of \$155 per Hectare, indexed, incurred by a Grower on or before 30 June 2000 and 30 June 2001 respectively, will be an allowable deduction;
- where a Grower borrows funds in order to fund their obligation to pay the Plantation Management Fees and incurs interest on such borrowings on or before the end of the respective year, that interest will be an allowable deduction; and
- where a Grower arranges to insure their Allotment against fire and other risks that insurance premium will be an allowable deduction.

Section 82KZM

30. The expenditure incurred by Growers, as described in paragraphs 26 to 28 above, does not fall within the scope of section 82KZM.

Section 82KL

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

Part IVA

32. The relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

33. Consideration of whether fees payable under the Agreements are deductible under section 8-1 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 paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about

whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

34. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the sale proceeds from the sale of 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.

35. 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.

36. For this Project Growers have, under the Plantation Management and Lease Agreements, 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 these Agreements Growers appoint CBGL, as Manager, to provide services such as planting, cultivating, tending, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers control their investment. The specific cost of these services provided in the first thirteen months will total \$292,000 under 'Option 1', and \$146,000 under 'Option 3'. CBGL will arrange marketing and sale of the Trees for a proportion of the proceeds.

37. The Plantation Management and Lease Agreements give Growers more than a chattel interest in the timber on harvest. The Project documentation contemplates Growers will have an ongoing interest in the growing trees - the trees are the Growers' property and Growers have a legal interest in the land being the lease itself.

38. Growers have the right to use the land in question for afforestation purposes and to have CBGL come onto the land to carry

out its obligations under the Plantation Management and Lease Agreements. The Growers' degree of control over CBGL, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on CBGL's activities. Growers are able to terminate the arrangement with CBGL in certain instances, such as cases of non-remedial material breach or non-observance of the Manager's obligations under the Plantation Management Agreement. The afforestation activities described in the Plantation Management and Lease Agreements are carried out on the Growers' behalf.

39. 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 'the costs of establishment, maintenance and harvesting are all realistic, reasonable and achievable...'. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Information Memorandum 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.

40. 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.

41. 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.

42. 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 paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. No capital component is identifiable. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions do not apply.

Section 82KZM

43. Under the Plantation and Management Agreement the fee of \$292,000 under 'Option 1' or \$146,000 under 'Option 3' will be incurred on execution of that Agreement. This fee is charged for providing a number of specified services to a Grower only for the period of 13 months from the execution of the Agreement. For the purposes of this Ruling, it is accepted that no part of the fee is for CBGL 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 \$292,000 under 'Option 1' or \$146,000 under 'Option 3'.

Section 82KL

44. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. There may be a loan provided to the Grower. The loan is provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

45. 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 Coonawarra Blue Gums 1999 Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of \$292,000 under 'Option 1' or \$146,000 under 'Option 3', allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

46. 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 initial fee of \$292,000 under 'Option 1' or \$146,000 under 'Option 3' or the annual fees of \$225 per hectare 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

47. 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 Plantation Management Fees to be incurred in the year ended June 1999 will be deductible. The interest fees incurred in the years ended 30 June 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 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

48. Insurance may be arranged to insure the Allotments 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

23 June 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

PR 98/1; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TD 93/34

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- 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

Legislative references:

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

Case references:

ATO references:

NO 99/4329-3

BO

FOI index detail: I 1020170

ISSN: 1039-0731

Price: \$1.30