



PR 1999/83 - Income tax: Environinvest Eucalypt Private Offering

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Product Ruling

Income tax: Environinvest Eucalypt Private Offering

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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 law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Environinvest Eucalypt Private Offering, 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 and 25-25 of the *Income Tax Assessment Act 1997* ('ITAA 1997'). The operation of sections 82KK, 82KL and 82KZM and Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936') is also dealt with.

Class of person/arrangement

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

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arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it. Specifically, the Ruling does not apply to persons who enter the arrangement and who exercise the buy-back election. So far as persons who exercise the buy-back election are concerned, circumstances surrounding the exercise of the election may be relevant to their entitlement to deductions. Those persons may seek a private binding ruling on the tax consequences of such action.

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

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 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 is based on the following documents:

- Application for Product Ruling dated 9 April 1999;
- The Prospectus by Environinvest Ltd ('Environinvest') for the Environinvest Eucalypt Project 1999, dated 19 March 1999;
- Draft Information Outline for Environinvest Eucalypt Private Offering;
- **Lease Agreement** between Blackburne Pty Ltd ('Blackburne') and S.T.Y. (Afforestation) Pty Ltd ('the Landlord') and Burke Bond Securities Ltd ('the Lessor' or 'BBSL') and the Grower ('the Lessee');
- **Management Agreement** between Environinvest and the Grower;
- **Loan Agreement** between Blackburne and the Grower ('the Borrower');

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- **Power of Attorney**, between the Grower ('the Applicant') and BBSL ('the Attorney');
- Trust Deed between Environinvest and BBSL; and
- Additional correspondence received from Abbott, Stillman & Wilson dated 1 June 1999, 4 June 1999 and 15 June 1999.

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

13. For the purposes of describing the arrangements to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate (within the meaning of section 318 of the ITAA 1936) of the Grower, will be a party to. The Documents highlighted are those the Growers enter into. The effect of these agreements is summarised as follows.

14. This arrangement is called the Environinvest Eucalypt Private Offering. Growers entering into the Project will lease land located in the Western District of Victoria from BBSL. BBSL as trustee of the Project has leased land from the Landlord, who has leased the land from Blackburne being the registered proprietor of the land. The Growers will also enter into a Management Agreement with Environinvest to have *eucalyptus globulus* (Blue Gums) planted on this leased land for the purpose of eventual felling and sale in approximately ten years.

15. The Leased Areas on offer are 0.5 hectares ('Allotment') each. The lease cost per Allotment is \$90 for the first year of the Project. The management fee for each Allotment for the first year is \$2,730. Maintenance fee for the second year is \$30 per Allotment. On going lease and maintenance fees each year thereafter will be subject to consumer price increases. A Grower must subscribe for a minimum of 178 Allotments. The total land area for the Project is 2,000 hectares although options are held over additional land which may be available to increase the number of available Allotments. There is no minimum subscription for the Project. A minimum of 500 seedlings per leased Allotment will be planted in the first 13 months following execution of the Lease and Management Agreements.

Lease Agreement

16. Under the Lease Agreement, Growers enter into a lease for at least 178 Allotments for a period from the commencement of the lease until the first clear fall of any trees planted on the Allotments. Clause 1 of the Lease Agreement grants an interest in the Allotment to

the Grower. Environinvest on behalf of BBSL will maintain a register of Growers. Growers are not entitled to assign the Lease Agreement except in certain circumstances (cl 5).

Management Agreement

17. Under the Management Agreement, Growers enter into an agreement which expires on the first clear fall of any trees planted on the Growers' Allotments subject to the Management Agreement. The contract with Environinvest is to establish and maintain the plantation of trees on the Growers' Allotments in accordance with good silvicultural practice (cl 1). Growers appoint Environinvest, as sole agent to market and sell the trees growing on the Growers' Allotments in a proper and competent manner (cl 5).

Fees

18. The fee payable under the Lease Agreement for the period to 30 June 2000 (the first year of the Project) is \$90 per Allotment (minimum of 178 Allotments). The fee payable under the Management Agreement for the period to 30 June 2000 (the first year of the Project) is \$2,730 per Allotment. The total lease and management fees for 178 Allotments for the period ending 30 June 2000 is \$501,960. Forecast expenditure of Environinvest indicates that of the \$2,730 management fee per Allotment the 'Manager's profit' is expected to be \$546.

19. BBSL will hold the application fees in trust for the Environinvest Eucalypt Private Offering. The relevant components of the application fees will be released to the Landlord and Environinvest following the execution of the Lease and Management Agreements.

20. After the first year of the project the lease fee per Allotment per year (\$90) will be based on the fee for the previous year increased by movements in the Consumer Price Index. The maintenance fee for the second year of the Project will be \$30 per Allotment. For each following year the maintenance fee per Allotment per year will be based on the fee for the previous year increased by movements in the Consumer Price Index. Environinvest will pay the premiums to insure the trees against fire and the costs of harvesting the trees. In return Environinvest will receive 5.0% of the net harvest proceeds per Allotment.

Planting

21. During the first 13 month period Environinvest will be responsible for planting *eucalyptus globulus* on the Allotments. From

this period on Environinvest will maintain the trees in accordance with good silvicultural practice. The services to be provided by Environinvest over the term of the Project are outlined in (cl 2) of the Management Agreement. The definition of the terms 'Plantation Establishment Services' and 'Management Services' referred to at (cl 2) are contained at (cl 1) of the Management Agreement. Environinvest will provide ongoing reports to the Growers on the progress of the plantations.

22. The harvest proceeds from the sale of the timber will be paid to BBSL. Within 21 days the Trustee will pay to Environinvest the costs incurred by Environinvest in undertaking the harvest and Environinvest's entitlement to 5.0% of the net harvest proceeds. The balance of the Net Proceeds of Sale will be distributed to the Growers in accordance with their percentage entitlement based on their number of Allotments.

Trust Deed

23. The role of the Trustee as trustee of the Project is to protect the rights and interests of Growers pursuant to the terms and conditions of the Trust Deed, the Lease Agreement and Management Agreement. It does not ultimately control the business of the Growers. Control is vested in the Growers through mechanisms provided in the Trust Deed, the Lease Agreement and Management Agreement.

24. The Trustee will:

- receive and disburse Growers' funds, where Growers elect to retain Environinvest to provide plantation establishment services;
- oversee Growers' interests (in land and under the various agreements);
- protect Growers' rights under the various agreements, subject to directions given to the Trustee by the Growers;
- attend meetings and protect Growers' interests in relation to other service providers; and
- collect and distribute the proceeds from harvesting timber sold on behalf of Growers by Environinvest.

25. The Trustee is obliged to provide regular reports to Growers and the Growers can remove the Trustee. One year after plantation establishment, Environinvest in its capacity as the manager, must give the Trustee a report regarding each planting area. The Trustee may appoint a valuer to carry out a valuation of any interest to which the

Trust Deed relates or of any plantation or of any part of the Trust Fund if the Trustee considers such a valuation is reasonably required.

26. The Trustee shall be paid as remuneration for acting as trustee of the Environinvest Eucalypt Trust ('the Trust') reasonable fees for all work additional to the duties agreed or anticipated to be conducted by the Trustee in the normal course of its duties. The Trust Deed specifies that all harvest income is to be paid to the Trustee and within 21 days of the payment Environinvest shall provide details to the Trustee of the Growers in respect of which the harvest products had been owned and the Trustee shall allocate such moneys to Growers in accordance with the Trust Deed.

Finance

27. Where Growers choose to enter into finance arrangements with Blackburne, a company associated with Environinvest the terms of the loan will be as follows:

- 45% deposit;
- interest paid annually in advance;
- no repayment of principal before expiration of the Project;
- no establishment fee;
- interest rate 7.25% fixed for 10 years; and
- security by mortgage over the lease of all Allotments of the Grower.

28. Environinvest is to be put in funds by the Grower upon application. With the exception of the manager's profit, the total funds received from Growers will be applied to meet the costs of the services Environinvest is to perform. The loan is full recourse and Blackburne will pursue full legal action against outstanding borrowers.

Ruling

Section 8-1

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

- all of the Lease Fee of \$90 per Allotment incurred by the Grower on execution of the Lease Agreement on or before 30 June 1999, will be an allowable deduction;

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- all of the Management Fee of \$2,730 per Allotment incurred by a Grower on execution of the Management Agreement on or before 30 June 1999 will be an allowable deduction; and
- where a Grower borrows funds in order to fund their obligation to pay part of the lease and management fees and incurs interest on such borrowing on or before 30 June 1999, that interest will be an allowable deduction.

30. For the years ending subsequent to 30 June 1999 section 8-1 of the ITAA 1997 will apply to Growers participating in this Project as follows:

- all of the Lease Fee per Allotment paid by a Grower prior to the commencement of the year of income to which the payment relates, will be an allowable deduction in the year of payment;
- all of the Maintenance Fee per Allotment paid by a Grower prior to the commencement of the year of income to which the payment relates, will be an allowable deduction in the year of payment; and
- any interest incurred by a Grower on borrowings to fund the first year Lease and Management Fees will be an allowable deduction in the year the interest expense is incurred.

Section 82KZM

31. The payments of the Lease Fees and Management / Maintenance Fees do not fall within the scope of section 82KZM of the ITAA 1936 subject to the tests contained in the section.

Section 82KK

32. Section 82KK does not apply to defer the timing of any deductions for the Lease Fees and Management / Maintenance Fees or interest on any loans taken out to fund payment of the Lease Fees and Management / Maintenance Fees.

Section 82KL

33. Section 82KL does not apply to deny any deductions for the Lease Fees and Management / Maintenance Fees or interest on any loans taken out to fund payment of the Lease Fees and Management / Maintenance Fees.

Part IVA

34. Part IVA does not apply to deny deductions for the Lease Fees and Management / Maintenance Fees or interest on any loans taken out to fund payment of the Lease Fees and Management / Maintenance Fees.

Explanations**Section 8-1**

35. Consideration of whether the Plantation Establishment Costs are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

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

36. 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.

37. 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;

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- 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.

38. For this Project Growers have, under the Lease Agreement, rights in the form of an equitable 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 Environinvest, as Manager, to provide services such as planting, tending, culling, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers control their investment. The specific cost of the lease of each Allotment is \$90 for the first year of the Project. The Management Fee for the first year of the Project is \$2,730 per Allotment. The management services for which the payment of \$2,730 per Allotment relates are to be provided in the first thirteen months of the Project.

39. The Lease Agreement gives 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.

40. Growers have the right to use the land in question for afforestation purposes and to have Environinvest come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over Environinvest 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 Environinvest's activities. Growers are able to terminate arrangements with Environinvest 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.

41. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. 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.

42. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify trees in which Growers have an interest. 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.

43. 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.

44. The fees associated with the afforestation activities, being the plantation establishment costs, 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 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. The fee appears to be reasonable. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

46. Insurance may be arranged to insure the trees against fire. Any insurance recovery will be assessable. The insurance premiums will 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.

Section 82KZM

47. Under the Lease Agreement and Management Agreement the fees for the first year will be incurred on execution of the respective Agreements. The Management Fee per Allotment 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 that no part of the Lease Fee of \$90 per Allotment or Management Fee of \$2,730 per Allotment is for the Landlord or Environinvest doing 'things' that are not to be wholly done within 13 months of the fee 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 for the Lease and Management Fees for the first year of the Project or the Lease and Maintenance Fees for the subsequent years of the Project.

Section 82KK

48. Section 82KK will only operate to defer any deduction allowable to a Grower where a deduction is claimed by the Grower where an associate of the Grower will not return the amount as assessable income until a subsequent year of income. While the Landlord, Environinvest and Blackburne may be associates none of the Growers will be associates of the Landlord, Environinvest or Blackburne. Accordingly, section 82KK will not apply to defer the timing of any of the deductions otherwise allowable to the Growers.

Section 82KL

49. Section 82KL's operation depends, amongst other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by Blackburne 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. Section 82KL will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

50. 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 Environinvest Eucalypt Project 1999 will be a 'scheme', commencing at the time of issue of the Prospectus. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of \$2,820 per Allotment for the first year of the Project and the deduction for the Lease Fees and Maintenance Fees for each subsequent year of the Project, 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.

51. Growers to whom this Ruling applies intend to stay in the scheme for the full term and derive assessable income from the eventual harvesting of the trees. Further, there are not any features of the Project, for example, such as the Lease and Management fee being 'excessive', 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

52. 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 is applied to determine whether the Lease Fees and Management / Maintenance Fees per Allotment to be incurred in the year ending 30 June 1999 will be deductible. The interest fees incurred in the year ending 30 June 1999 and subsequent years 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.

53. 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 is applied to determine whether the Lease Fees and Management / Maintenance Fees per Allotment to be incurred in the year ending 30 June 1999 will be deductible. The interest fees incurred in the year ending 30 June 1999 and subsequent years 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.

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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 94/25;
TR 97/11; TR 97/16; TD 93/34

Subject references:

- carrying on a business
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- producing assessable income
- product rulings
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Legislative references:

- ITAA1936 82KK
- ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 8-1
- ITAA1997 25-25

Case references:

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