

PR 2000/106 - Income tax: ITC Pulpwood Project - 2000 Prospectus No. 1 - Supplementary Prospectus

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Product Ruling

Income tax: ITC Pulpwood Project – 2000 Prospectus No. 1 - Supplementary Prospectus

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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**, **Previous Rulings**, **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 1999/95** 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.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the ‘track record’ of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

Potential investors may wish to refer to the ATO’s Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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 ITC Pulpwood Project – 2000 Prospectus No. 1 - Supplementary Prospectus, or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 (ITAA 1997)
 - section 17-5 (ITAA 1997);
 - Division 27 (ITAA1997);
 - Division 35 (ITAA1997);
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZM (ITAA 1936);
 - section 82KZMA (ITAA 1936);
 - section 82KZMB (ITAA 1936);
 - section 82KZMC (ITAA 1936);
 - section 82KZMD (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. 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'.

8. 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

9. The Commissioner rules on the precise arrangement identified in this 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

11. This Ruling applies prospectively from 11 October 2000 the date the 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).

12. 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, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. 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.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2000/81, which is withdrawn on and from the date this Ruling is made. Product Ruling 2000/81 will continue to apply to investors who entered into the Project on or after 21 June 2000 and on or before 11 October 2000.

Arrangement

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

- Application for Product Ruling dated 10 January 2000, 9 June 2000 and 9 August 2000;
- Draft ITC Pulpwood Project – 2000 Prospectus No. 1, undated, issued by ITC Project Management Limited (ITCPM). The Prospectus pertains to the four Schemes listed below;
- Draft Identical Constitution for each Scheme executed by ITCPM, undated;
- Draft Compliance Plan for each Scheme executed by ITCPM as the Responsible Entity, undated;
- **Draft Lease for each Scheme, between ITCPM and the Grower (except the Queensland Scheme);**
- **Draft Forest Right for the Queensland Scheme, between ITCPM and the Grower;**
- **Draft Management Agreement for each Scheme between ITCPM [the ‘Manager’] and the Grower;**
- Draft Supplementary Prospectus dated 16 June 2000;
- Draft Loan Application between ITC Finance Pty Ltd and the Grower;
- Additional correspondence dated 23 February 2000, 9 March 2000, 14 March 2000, 16 March 2000, 22 March 2000, 9 June 2000, 9 August 2000, 5 September 2000 and 29 September 2000.

Note: Certain information received from ITC Project Management Limited has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

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16. The documents highlighted are those the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to, with the exception of finance agreements, to which paragraphs 41 to 45 applies. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called ITC Pulpwood Project – 2000 Prospectus No. 1 - Supplementary Prospectus

Composition of the Project	<ul style="list-style-type: none"> • ITC Pulpwood 2000 Green Triangle Scheme; • ITC Pulpwood 2000 West Australian Scheme; • ITC Pulpwood 2000 Esperance Scheme; and • ITC Pulpwood 2000 Queensland Scheme.
Unit of investment	Plantation Unit
Locations	<ul style="list-style-type: none"> • Green Triangle region of western Victoria and south eastern South Australia; • South west and southern coastal regions of Western Australia; • Esperance region of Western Australia; and • Sub-tropical region of southern Queensland.
Type of business each participant (Grower) is carrying on	Commercial growing, and cultivation of Tasmanian blue gum (<i>E. globulus</i>), or flooded gum (<i>E. grandis</i>) and river red gum, a flooded gum hybrid, (<i>E. grandis</i> x <i>E. camaldulensis</i>) in the Queensland Scheme, for the purpose of producing timber for woodchipping and any other suitable product.
Number of hectares under cultivation	10,000
Name used to describe the product	ITC Pulpwood Project – 2000 Prospectus No. 1 - Supplementary Prospectus
Size of each Plantation Unit	Varies, average sizes are*: <ul style="list-style-type: none"> • 0.87 hectares for the Green Triangle & Western Australia; • 1.08 hectares for Esperance; and

	<ul style="list-style-type: none"> 0.94 hectares for Queensland.
Number of trees per hectare	800
Expected production	Varies, average m ³ /hectare are*: <ul style="list-style-type: none"> 300 in the Green Triangle and Western Australia; 260 in Esperance; and 350 in Queensland.
Term of the investment in years	Approximately 10
Initial cost per hectare (for a minimum subscription of four [4] Plantation Units)	<ul style="list-style-type: none"> \$3,160.30 for the Green Triangle & Western Australia; \$2,545.40 for Esperance; and \$2,924.90 for Queensland.
Initial cost (for a minimum subscription of four (4) Plantation Units)	\$11,000
Ongoing costs (for a minimum subscription of four [4] Plantation Units)	<ul style="list-style-type: none"> Management: \$121 per Plantation Unit (indexed after the first (1st) year); and Lease: \$264 per Plantation Unit (indexed).

* Note: Expected production per Plantation Unit is 260 m³.

18. Growers applying under the Draft Prospectus enter into a Lease or Forest Right and a Management Agreement with ITCPM (the Project Manager). The lease/forest right gives a Grower a lease/forest right from ITCPM, over an identifiable area of land called a 'Plantation Unit' until the trees are harvested and sold, and net income distributed.

19. The Project Land is situated in four locations:

- the Green Triangle region of western Victoria and south eastern South Australia;
- South west and southern coastal regions of Western Australia;
- Esperance region of Western Australia; and
- Sub-tropical region of southern Queensland.

20. ITC estimates that approximately 50% of the land will be owned by ITC Timberlands Limited and the remainder will be leased.

21. ITC Timberlands Limited will either lease the properties or grant a Forest Right to ITCPM. ITCPM will then sublease or grant a Forest Right for the same land (as Plantation Units) to the Grower to carry on the Grower's business.

22. There is no minimum subscription for this Project. The Prospectus states that 10,000 hectares of land have been selected and further land may be acquired for planting if needed. Each investor is required to subscribe for a minimum of four (4) Plantation Units in any combination of areas, at a cost of \$2,200 per Plantation Unit plus a fixed fee of \$2,200. The expected yield from each Plantation Unit is 260 cubic metres of timber. As soil type, climatic conditions and tree species affect projected yields the Plantation Units will vary in size on the basis of expected return in relation to those variables. The average size of the Plantation Units in each Scheme are:

- 0.87 hectares for the Green Triangle & Western Australia;
- 1.08 hectares for Esperance; and
- 0.94 hectares for Queensland.

Trees will be planted during winter in each area except Queensland where the planting will be in summer.

23. Possible projected returns for Growers are outlined on pages 7-9 of the Draft Prospectus. The projected returns depend on a range of assumptions and the Project Manager does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Based on the table set out on page 7 of the Draft Prospectus, a Grower could expect to achieve after tax returns in the range of 8.7% to 12.3% depending on the location and the number of Plantation Units purchased. Growers will execute a Power of Attorney enabling ITCPM as the Project Manager to act on their behalf as required when they make an application for Plantation Units.

Constitution

24. The Constitution establishes the responsibilities of ITCPM as the Responsible Entity. It sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity:

- ensures that Application Funds are not released until appropriate agreements etc are in place (cl. 8);
- prepares the Management Agreement & lease documents (cl. 6);
- distributes the profits (cl. 30); and
- keeps a register of Growers (cl. 27).

Compliance plan

25. The Project Manager has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Project Manager meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in land

26. A Lease or a Forest Right, for the Queensland project is granted by the Responsible Entity to the Grower under the terms of the Lease or Forest Right (cl. 2). Growers are granted an interest in land in the form of a Lease or a Forest Right to use the said land for the purpose of conducting their afforestation business (cl. 4). Growers must pay the granter of the Lease or Forest Right a fee of \$264 per Plantation Unit per annum (cl. 7) commencing 31 December 2000. This fee is indexed annually. The term of a Grower's Lease or Forest Right is up to the date the trees on the Plantation Units have been harvested and sold and the Responsible Entity pays the proceeds into the Proceeds Fund. In certain circumstances Growers are entitled to assign their Lease or Forest Right (cl. 13).

Management Agreement

27. A Management Agreement is entered into between the Responsible Entity and the Grower for each Plantation Unit. The termination of the Project is after completion of harvest of all plantations comprising the Project (item 5 of schedule 1).

28. Growers contract with the Responsible Entity to establish and maintain the plantation until maturity. Growers pay the Management Fees for the term of the Project. The initial Management Fee is \$2,200 per Plantation Unit plus a fixed fee of \$2,200 for plantation preparation and establishment costs including the provision of Management Plan and seedlings (item 1 of schedule 3). The fee for planting is \$154 for each Plantation Unit payable on 31 December 2000 (item 2 of schedule 3). The annual Management fee is \$66 (indexed after the first payment) per Plantation Unit plus a fixed fee of \$220 commencing 31 December 2000 for the year ended 30 June 2001 (item 3 of schedule 3).

29. The Responsible Entity will purchase and plant *Eucalyptus globulus* trees for the Green Triangle, Western Australia and Esperance Schemes and *Eucalyptus grandis* and *Eucalyptus grandis* x *Eucalyptus camaldulensis* hybrid trees for the Queensland Scheme. It will also cultivate, maintain, replant, fertilise, water, prune, tend maintain and otherwise care for the Plantation Unit as and when

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required according to good silvicultural and forestry practices to produce mature trees suitable for woodchipping.

30. The Responsible Entity guarantees that, providing land is available for investment, the Primary Services consisting of the preparation of a Management Plan, obtaining all necessary approvals, purchase of seedlings, supervision & management of work and administration (item 1 of schedule 2 to the Management Agreement) will be provided by 30 June 2001 (Draft Prospectus page 2).

31. The Responsible Entity will harvest and sell the timber produce on the Growers' behalf (item 4 of schedule 2). The Grower may elect to market and arrange for the sale of the Tree Crop (cl. 9). The Responsible Entity will arrange insurance for the Growers at their request and cost (item 3(s) of schedule 2).

32. The Responsible Entity may be removed from its appointment by an ordinary resolution of Growers if the Growers take action under Division 1 of Part 2G.4 of the Corporations Law if the Responsible Entity:

- is in breach of the Management Agreement and has not remedied the breach (cl. 6); or
- has retired or is removed as the Responsible Entity (cl. 6).

Fees

33. Summary of the fees payable under clause 5 of the Management Agreement are:

	Year 1	Year 2	Year 3
Primary Services fee (a)– fixed component (b) per Plantation Unit	\$2,200.00 \$2,200.00		
Planting – per Plantation Unit	\$154.00		
Management Fee – fixed amount	\$220.00	\$220.00	\$ 220.00
Management Fee – per Plantation Unit	\$66.00	\$66.00 (indexed)	\$66.00 (indexed)
Total for four (4) Plantation Units	\$12,100.00	\$484.00	\$484.00

34. The Primary Services fee comprises a fixed component of \$2,200 per Grower plus a further amount of \$2,200 per Plantation Unit. A Grower can subscribe to more than four Plantation Units.

The total Primary Services fee is for the preparation of a Management Plan for the Plantation Units, obtaining all necessary approvals, purchase of seedlings, supervision and management of work and administration (item 1 of schedule 2 to the Management Agreement). This initial fee is payable upon application to the Project.

35. The Planting Services fee of \$154 per Plantation Unit is for planting and supervision and management of the seedlings. These amounts are due and payable on 31 December 2000 or on execution of the Management Agreement if later than 31 December 2000 (item 2 of schedule 3 to the Management Agreement).

36. The annual Management fee is \$66 per Plantation Unit plus a fixed fee of \$220 commencing 31 December 2000 for the year ended 30 June 2001. The \$66 fee will be increased yearly after the first payment by the percentage increase in the Consumer Price Index Australia (All Groups) from the immediately preceding year (item 3 of schedule 3 to the Management Agreement). The management fee is in respect of the management of the crop including fertilisation, weed and pest control, fire control, arranging insurance (when requested), inspection and preparation of reports.

37. The Independent Forester has stated in its report that "The claims made in the Prospectus and in supporting documents concerning growth rates are largely based on actual experience and appear achievable on a Project level provided the same high level of management applied to their existing estate is applied to the Project" (p 36 of the Draft Prospectus).

38. The Application Monies will be banked in the Application Bank Account formed under the Project's Constitution (cl. 3.3(b) of the Constitution). Upon acceptance of an Application the Responsible Entity shall release the relevant application monies from the Application Fund trust bank account and apply them in payment of the fees under the Management Agreement in respect of the Primary Services of the Management Agreement (cl. 9 of the Constitution).

Planting

39. *Eucalyptus globulus* trees will be planted in winter in the Green Triangle region of western Victoria and south eastern South Australia, South west and southern coastal regions of Western Australia and the Esperance region of Western Australia. *Eucalyptus grandis* and *Eucalyptus grandis* x *Eucalyptus camaldulensis* hybrid trees will be planted in summer in the sub-tropical region of southern Queensland. After planting the Responsible Entity will maintain the trees in accordance with good silvicultural practice. The services to be provided by the Responsible Entity over the Project's term are outlined in the Management Agreement (cl. 3). The Responsible

Entity will be responsible for arranging the marketing and sale of the timber produce (cl. 3). The Responsible Entity is entitled to a Harvest Fee of 5% of the Harvest Proceeds (item 4 of schedule 3 to the Management Agreement).

40. The proceeds of sale of the timber produce will be banked in the Proceeds Fund bank account formed under the Project's Constitution (cl. 3.3(c)). Proceeds received by the Responsible Entity are to be distributed to the Grower after deductions of:

- amounts for any outstanding Annual Fees and to reimburse the Responsible Entity for operational expenses and harvest fee; and
- any other amounts of tax or duty which is payable by the Responsible Entity on behalf of the Grower (cl. 31.1 of the Constitution).

Finance

41. Growers investing in the Project may either fund their investment personally, arrange finance themselves or, subject to satisfying certain criteria, use a financing facility provided by ITC Finance Pty Ltd (ITCF), an associate of ITCPM. It is proposed that ITCF will borrow funds from a bank, and possibly ITC, and on-lend these funds to Growers who request finance. All funding will be on a full recourse basis.

42. The terms of ITC Tree Farm Loan offered by ITCF provide for four options for loan periods varying between 12 months and 10 Years. The loans include an interest free period up to 30 June 2001 and thereafter, interest will be charged at the prevailing National Australia Bank Benchmark rate plus 1.35% (where the loans are for a five or seven year period) and 1.85% (where the loan is for a 10 year term).

43. Repayments are to be made on the following basis:

- 10% to be repaid within one month after the end of the quarter in which the loan is made;
- equal monthly principal and interest payments commencing 31 July 2001 (no interest for 12 month loans); and
- there is also an option to repay 20% of the loan in November 2001, if this option is selected by 31 May 2001.

44. Security for the loan will be the interest in the Plantation Units. Borrowers must provide ITCF with authority to debit their bank account for repayments. Interest payments made under an ITC Tree

Farm Loan is not considered to have any prepayment element attached.

45. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project, other than ITC Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Assessable income

46. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5 ITAA 1997. Section 17-5 ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Deductions where a Grower is not registered or required to be registered for GST

47. A Grower may claim tax deductions in the Table below where the Grower:

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- participates in the Project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 33 to 36; and
- is not registered nor required to be registered for GST.

	ITAA 1997 section	Year 1	Year 2	Year 3
Primary Services fee (a)– fixed component (b) per Plantation Unit	8-1	\$2,200.00 \$2,200.00		
Planting – per Plantation Unit	8-1	\$154.00		
Management Fee – fixed amount	8-1	\$220.00 - see notes (i) & (ii) below	\$220.00 - see notes (i) & (ii) below	\$220.00 - see notes (i) & (ii) below
Management Fee – per Plantation Unit	8-1	\$66.00 - see note (ii) below	\$66.00 (indexed) - see note (ii) below	\$66.00 (indexed) - see note (ii) below
Lease Fee - per Plantation Unit	8-1	\$264.00	\$264.00 (indexed) - see notes (i) and (ii) below.	\$264.00 (indexed) - see notes (i) and (ii) below.
Interest	8-1	As incurred - see notes (ii) & (iii) below	As incurred - see notes (ii) & (iii) below	As incurred - see notes (ii) & (iii) below
Total for four (4) Plantation Units		\$13,156.00	\$1540.00	\$1540.00

Notes:

- (i) Where a Grower incurs the management fees and lease fees as required by the Management Agreement and Lease Agreement, those fees are deductible in full in the year incurred. However, if a Grower chooses to prepay fees for the doing of things that will not wholly be done in the same income year as the fees are incurred, then the prepayment rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fees **must** be determined

using the formula shown in paragraph 50 unless the expenditure is 'excluded expenditure'.

- (ii) Amounts of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. Deductibility of amounts that exceed \$999, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as prepaid Management fees, i.e., using the formula shown in paragraph 50.
- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project, other than with ITCF, is outside the scope of this Ruling. However, under the prepayment rules applying to the Project, 'agreement' is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. Therefore, all Growers who enter into agreements to finance their participation in the Project, other than with ITCF, should read carefully the information provided in paragraph 81 to 83.

Deductions where a Grower is registered or required to be registered for GST

48. Where a Grower who is registered or required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 33 to 36; and
- is entitled to an input tax credit for the fees

then the tax deductions in the Table in paragraph 47 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 96.

Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA

49. For a Grower who participates in the Project and incurs expenditure in accordance with the Lease Agreement and the Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- (i) the expenditure by Growers does not fall within the scope of section 82KZM (but see paragraphs 69-77);
- (ii) the expenditure by growers does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 69-77);
- (iii) the expenditure by growers does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 69-77);
- (iv) section 82KL does not apply to deny the deductions otherwise allowable; and
- (v) the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Prepaid fees

50. In this Project the Lease and Management Agreements that Growers enter into do not require fees to be paid by Growers prior to the commencement of each eligible service period. If however, a Grower chooses to incur expenditure in respect of services to be provided for a period that has not yet commenced then the prepayment will not be deductible in full in the year in which it is incurred. Rather, using the formula shown below, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided (see paragraphs 69 to 77).

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

Section 35-55 – losses from non-commercial business activities

51. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2010 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

52. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or

- the 'Exception' in subsection 35-10(4) applies (see paragraph 87 in the Explanations part of this ruling, below).

53. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

Explanations

Section 8-1

54. Consideration of whether the fees under the Management Agreement and the Lease Agreement are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing 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 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 in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

55. 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.

56. Generally, a Grower will be carrying on a business of afforestation where:

- the Grower 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 Grower'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.

57. For this Project Growers have, under the Lease or Forest Right and Management Agreements, rights in the form of a lease or a forest right over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Lease or Forest Right and Management Agreement Growers appoint ITCPM, as Responsible Entity, to provide services such as supplying seedlings, planting, fumigating and poisoning for exterminating and controlling the Plantation Unit from rabbits, insects and other vermin, spraying for control of weeds, fertilising, cultivating, tending and otherwise caring for the trees as and when required according to good silvicultural and forestry practices. Growers are considered to control their investment. The initial specific cost of the services provided by 30 June 2001 is \$2,200 plus \$2,200 per Plantation Unit. The remaining cost of the services to be provided by 30 June 2001 are: for Management; a fixed fee of \$220 and a \$66 fee per Plantation Unit; a planting a fee of \$154 per Plantation Unit; and a rental fee of \$264 (indexed) per Plantation Unit.

58. The Lease or Forest Right gives Growers the full right, title and interest in the products and the right to sell or have the products sold for their benefit (clause 3) until the end of the lease term.

59. Growers have the right to use the land in question for afforestation purposes and to have the Responsible Entity come onto the land to carry out its obligation under the Management Agreement. The Growers' degree of control over the Responsible Entity, 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 the state of the Tree Crop and ITCPM's activities. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as where the Responsible Entity has failed to perform any of its duties with due care and diligence. The afforestation activities described in the Lease or Forest

Right Agreements and Management Agreements are carried out on the Growers' behalf.

60. 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. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Draft 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. The Independent Forester's assessment was that plantation yields will be economically viable.

61. 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.

62. 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.

63. 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, therefore, come within paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The tests of deductibility under section 8-1 are met. The exclusions do not apply.

Interest deductibility

i *Growers who use ITC Finance Pty Ltd as the finance provider*

64. Some Growers may finance their participation in the Project through a loan facility with ITC Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

65. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of afforestation and is therefore directly

connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

ii. *Growers who DO NOT use ITC Finance Pty Ltd as the finance provider*

66. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than ITC Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

67. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid for a period that is wholly or partly outside the income year in which the income is incurred. Unless such prepaid interest is 'excluded expenditure' any tax deduction that may be allowable will be subject to the relevant prepayments provisions of the ITAA. 'Excluded expenditure' is an amount of expenditure of less than \$1,000.

68. The prepayments provisions are discussed in detail at paragraphs 69 to 77 of this Ruling. However, in broad terms, where interest is prepaid and the period to which the interest relates is wholly or partly outside the income year in which it is incurred, then any tax deduction that is allowable must be determined using the following formula;

$$\text{Interest} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

In the formula, the 'eligible service period' means, generally, the period to which the interest applies.

Prepayments provisions - sections 82KZM, 82KZMB – 82KZMD, and 82KZME –82KZMF

69. The prepayment provisions of the ITAA operate to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full under section 8-1 of the ITAA 1997. The section applies to certain expenditure incurred under an agreement in return for doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

70. Under the Management Agreement, a fixed fee of \$2,200 plus a fee of \$2,200 per Plantation Unit will be incurred on the execution of this Agreement. The fees are charged for providing services to a

Grower by 30 June of the year of execution of the Agreement. The fees are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fees have been inflated to result in reduced fees being payable for subsequent years.

71. There is also no evidence that might suggest the services covered by the fees could not be provided in the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Project Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 47 then the basic precondition for the operation of the prepayment provisions are not satisfied and it will not apply to the expenditure incurred by the Grower.

72. New sections 82KZMB, 82KZMC and 82KZMD will also have no application to this Project, provided the Grower incurs the fees as they fall due under the Lease and Management Agreements, since the services to be provided in respect of the initial fee are completed in the same year of income as the expenditure is incurred.

73. The amount and timing of deductions for any prepaid Management Fees, Lease Fees or interest otherwise deductible under section 8-1 will depend on when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided.

74. Where a Grower participating in this Project incurs expenditure in respect of the doing of things (e.g., the performance of management services or the lending of money), prior to the commencement of the eligible service period, the prepaid expenditure is not deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and whether the Grower is a 'small business taxpayer'.

75. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

Expenditure x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

76. Although not required under the Arrangement described in this Product Ruling, where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a small business taxpayer or section 82KZMD if the Grower is not a small business taxpayer. For small business taxpayers the amount and timing of the allowable deductions will then be calculated under the formula in subsection 82KZM(1) and for non-small business taxpayers under the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 75 above, concerning section 82KZMF.

77. Prepaid management and lease fees of less than \$1,000 in each expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(4) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid management fees or prepaid lease fees is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Small business taxpayers

78. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

79. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

80. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

Division 35 - losses from non-commercial business activities

81. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law

partnership) from certain business activities will not be allowable in an income year unless:

- the ‘Exception’ in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

82. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer’s allowable deductions attributable to the business activity over that taxpayer’s assessable income from the business activity.

83. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

84. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities ‘of a similar kind’. Under subsection 35-10(4), there is an ‘Exception’ to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

85. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

86. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income

year ended 30 June 2010. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

87. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

88. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

89. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

90. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 51), in the manner described in the Arrangement (see paragraphs 15 to 45), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

91. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent forester.

Section 82KL

92. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. 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 - general tax avoidance provisions

93. 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).

94. The ITC Pulpwood Project - 2000 Prospectus No. 1 - Supplementary Prospectus Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 47 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.

95. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the timber. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example**Example 1 – entitlement to 'input tax credit'**

96. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the 'value of the taxable supply' for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Detailed contents list

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Commissioner of Taxation

11 October 2000

<i>Previous draft:</i>	- tax shelters
Not previously issued in draft form	- tax shelters project
<i>Related Rulings/Determinations:</i>	<i>Legislative references:</i>
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1936 82KL
TR 97/11; TR 97/16; TR 98/22; TD	- ITAA 1936 82KZM
93/34;	- ITAA 1936 82KZMA
	- ITAA 1936 82KZMB
	- ITAA 1936 82KZMC
<i>Subject references:</i>	- ITAA 1936 82KZMD
- afforestation	- ITAA 1936 82KZME
- carrying on a business	- ITAA 1936 82KZMF
- commencement of business	- ITAA 1936 82KZMF(1)
- management fee expense	- ITAA 1936 177A
- producing assessable income	- ITAA 1936 177C
- product rulings	- ITAA 1936 177D
- public rulings	- ITAA 1936 Pt IVA
- schemes and shams	- ITAA 1997 6-5
- taxation administration	- ITAA 1997 8-1
- tax avoidance	- ITAA 1997 8-1(1)(a)
- tax benefits under tax avoidance schemes	- ITAA 1997 35-10

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- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350

ATO references:

NO 99/18825-1

BO

FOI number: I 1022558

ISSN: 1441-1172