



PR 2000/71 - Income tax: Willmott Forests - 2000 Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 November 2001*



Product Ruling

Income tax: Willmott Forests - 2000 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**, **Previous Ruling**, **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.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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.

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 Willmott Forests – 2000 Project, 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* (ITAA1997);
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- Division 35 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMB – 82KZMD (ITAA 1936);
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant laws(s) are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. 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’.

7. 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

8. The Commissioner rules on the precise arrangement identified in the Ruling.

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at **paragraphs 15 to 34** 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

11. This Ruling applies prospectively from 14 June 2000, 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).

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, this 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 2002. 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 2000/3, which is withdrawn on and from the date this Ruling is made. Product Ruling 2000/3 will continue to apply to investors who entered into the Project on or before 31 May 2000.

Arrangement

15. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- application for a Product Ruling, dated 26 October 1999;
- Willmott Forests - 2000 Project Prospectus dated 20 October 1999;
- The Willmott Forests - 2000 Project Constitution;
- **Lease Agreement** between Willmott Forests Ltd ('WFL'), the Lessor and the Grower;
- **Forestry Management Agreement** between WFL and the Grower;

- Compliance Plan for Willmott Forests Limited as the Responsible Entity, undated;
- Letters from applicant dated 1 and 15 December 1999.
- Facsimile advice from Willmott Forest Ltd dated 18 and 25 May 2000.

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.

16. The documents highlighted are those in which Growers enter into or become a party to except any which might relate to a financing arrangement to which paragraph 33 applies. 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.

17. This arrangement is called the Willmott Forests - 2000 Project. Growers participating in the Project enter into a Lease Agreement. Growers lease an area of land called a 'Hectare' from Willmott Forest Limited (WFL) for 25 years. The Forestry Management Agreement will commence 30 June 2000, and the Growers will have certain pine trees (*Pinus Radiata*) planted on the leased area for the purpose of eventual felling and sale.

18. There is no minimum amount that must be raised under the Prospectus. A Grower must apply for a minimum of 1 Hectare. A minimum of 1,000 trees per Hectare will be planted by 31 July 2001, following execution of the Lease and Forestry Management Agreements. Possible projected returns for Growers are outlined on page 34 of the Prospectus.

19. The projected returns depend on a range of assumptions and WFL 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 Forestry Management Agreements being offered pursuant to the Prospectus. Based on the example set out on page 35 of the Prospectus, a Grower could expect to achieve an internal rate of return of 10.1% per Hectare (Option A - Cash). Growers may execute a power of attorney enabling another person to act on their behalf as required, when they make an application for a Hectare it is not proposed to accept applications after 30 June 2000.

Forestry Management Agreement

20. A Forestry Management Agreement is entered into between WFL and each Grower. Growers contract with the Manager to establish and maintain the plantation until maturity. The Manager shall use all reasonable endeavours to complete the following works in

accordance with good forestry practices in respect of the leasehold property. WFL may delegate responsibilities.

Part 1 - preparation and planting

Growers who are accepted into the Project on or before 30 June 2000, WFL shall perform the work within 13 months of the commencement of the Agreements. Work to be done is:

- planning – development of Plantation Establishment Plan;
- soil testing;
- allocation and survey;
- preparation works;
- pre-planting weedicide treatments as required;
- supplying and planting *Pinus Radiata* seedlings at a minimum rate of 1000 per Hectare;
- consultant Forester's fees and expenses; and
- public risk insurance of \$10,000,000.

The commencement date of Part 1 is 30 June 2000

Part 2 – maintenance (years 2-25)

WFL may delegate its responsibilities. If any amount is not paid by the due date interest may be charged and the Agreement terminated.

Work to be done in 2nd year:

- replanting where required;
- treatment of regrowth;
- post planting weedicide treatments as required;
- folia analysis of planted stock;
- fertilising where required;
- construction of access roads and firebreaks; and
- general maintenance.

Work to be done in 3rd year:

- general maintenance, including attention to regrowth, access roads and firebreaks, fertilising, where required.

Work to be done in 4th year:

- general establishment work and maintenance including attention to regrowth, access roads and firebreaks.

Work to be done in 5th to 25th:

- further fertilising, general maintenance including attention to regrowth, access roads, firebreaks and selective pruning;

Sundries:

- fire insurance for 9 years from second year of the Project to the tenth year of the Project (both inclusive); and
- public risk insurance for period from second year of the Project to the twenty-fifth year of the Project, \$10,000,000.

After year 10 the decision to further insure against fire is the Grower's responsibility.

The commencement date of Part 2 is 30 June 2001.

Constitution

21. The Constitution sets out the terms and conditions under which WFL agrees to act for the Growers and to manage the Project.

22. Within 30 days of lodgement of an Application, WFL is required to advise whether it has been accepted or rejected. Where the application is accepted, the Manager has two months to place the applicant ('Grower') on the register and provide the Grower with a copy of the Forestry Management Agreement and Lease Agreement. At the conclusion of the Project the Manager has 180 days to sell all of the assets and pass on the net proceeds, after covering costs, to the Growers. The Grower may transfer any of their interest in the Project. Growers are bound by the Constitution by virtue of their acceptance into the Project.

23. The Grower may complete a Power of Attorney to allow WFL to enter into the agreements on the Grower's behalf and to execute and deliver the agreements. The Power of Attorney is to last until 30 June 2001.

Fees

24. Growers lease one or more Hectares of land for a term of twenty-five years with annual rental payable.

25. Growers, on commencing to lease the relevant land, enter into the Forestry Management Agreement to develop, establish and maintain the plantation over the period of the lease.

26. All Application Monies (Part 1 Preparation & Planting) will be deposited into a trust account known as the Willmott Forest Limited-

2000 Project Application Account. Upon acceptance of an Application for Hectares these funds will be released from the Application Account and paid to the Manager.

27. The fees payable under the Lease, and Forestry Management Agreements are:

Forestry Management Agreement

Part 1 - Preparation & Planting (year 0-1)	\$5,000 /Ha
+ GST @ 10%	\$ 500/Ha

Payment Options

Option A - Payable upon application	\$5,500/Ha
Option B – Deposit payable upon application	\$ 500/Ha
Balance payable by 30 June 2000	\$5,000/Ha

Part 2 - Maintenance (year 2–11)

\$100 /Ha/pa + GST @ 10% \$110/Ha/pa

This fee is payable quarterly in arrears.

Plus 5% of gross timber proceeds received from thinning and clear fell of trees on each hectare of the Leasehold property. The Manager shall deduct these fees from gross timber proceeds prior to distribution to Growers.

Lease Agreement

Year 1-25 + GST @ 10% \$220/Ha/pa

Lease payment amount will be CPI adjusted from year 11.

This fee is payable quarterly in arrears.

Lease Agreement

28. The Lease is granted by WFL to Growers under the terms of the Lease Agreement. Growers are granted an interest in land in the form of a lease to use their Hectare for the purposes of conducting their afforestation business, including the right to harvest timber grown on the Hectare.

29. The lease is for 25 years commencing from 30 June 2000 at a cost of \$220 per hectare per annum (including GST) adjusted for CPI from year 11. The lease may be extended by 5 years or until such time as the trees have been harvested and the land made good.

30. The lessee shall not use the land jointly with anyone else and retains the right to say when the trees are to be planted. The land can only be subleased or disposed of with the lessor's approval. If the

lessee defaults, the lessor can take possession of the land. If the lessee breaches any conditions, the lessor may enter the land to remedy the breaches at cost to the lessee. If the trees are destroyed and insurance proceeds obtained but not used for replanting, the Lease Agreement may be cancelled and no further obligations exist.

Marketing/Sales

31. At all times, marketing/sale of timber is the Grower's decision (cl. 13 of the Constitution). The Grower may engage the Manager to arrange for these works to be carried out at the appropriate time. The Manager's fees and expenses for doing so would not exceed 5% of Gross Timber Proceeds (net of GST).

32. Where the Manager undertakes these works it is anticipated the proceeds of sale of the *Pinus Radiata* will be paid into the Trust Account. Proceeds received by Willmott Forests Limited are to be distributed in the following order of priority:

- To Willmott Forests Limited for any outstanding Annual Fees and to reimburse Willmott Forests Limited for its out of pocket expenses and interest; then
- To the Growers (cl. 17 of the Constitution).

Finance

33. Growers may fund the investment themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is involved in the provision of financing for the Project.

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

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project are or become involved in the provision of the finance;
- indemnity arrangements, or equivalent collateral arrangements limiting the borrower's risk;
- non-arm's length terms and conditions;
- additional benefits, for the purposes of section 82KL, are granted to borrowers, or the funding arrangement transforms the Project into a 'scheme' to which Part IVA may be applied;
- the loan or rate of interest is non-arm's length.

- repayments of principal and payment of interest are linked to derivation of income from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and directly, or indirectly), back to the lender, or any associate; or
- lenders do not have the capacity under the loan agreement, or do not have a genuine intention, to take legal action against defaulting borrowers.

Ruling

Section 6-5 - Assessability of income from the project

35. For a Grower who invests in the Project any income received by them from the sale of their timber will be assessable income to them under section 6-5.

Sections 27-5 and 27-30 - Goods and Services Tax

36. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Section 8-1 - Allowable deductions

37. For a Grower who invests in the Project, the deduction available for the prepaid management fee, will depend upon the date that the investment is made and, in some cases, whether or not they are 'small business taxpayers'.

IMPORTANT: Paragraph 38 (relating to 'small business taxpayers') and paragraphs 39 to 40 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 43 to 45 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

Deductions for Growers who are 'small business taxpayers'

38. For a Grower who is a 'small business taxpayer' and invests in the Project on or before 30 June 2000, the deductions shown in the

Table below will be available for the years ended 30 June 2000 to 30 June 2002.

Fee type	ITAA 1997 Section	Deductions for small business taxpayers only. <u>Per Hectare</u>		
		Year 1	Year 2	Year 3
		30/6/2000	30/6/2001	30/6/2002
Preparation and Planting Fee	8-1	\$5000 see note (i) below		
Annual Maintenance Fee	8-1		\$100	\$100
Lease Fee	8-1	\$200 see note (i) below	\$200	\$200

(All figures shown are exclusive of GST)

Notes:

- (i) Legislative change means that the full deduction will not be allowed in the year ended 30 June 2000 for Growers who are not 'small business taxpayers'. See paragraphs 39 to 41 and the Example at paragraph 78.

Deductions for Growers who are not 'small business taxpayers'

39. For a Grower who invests in the Project on or before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deduction available in respect of the management and lease fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (The Example at paragraph 78 illustrates the application of this method).

40. In calculating the deduction available, the term 'expenditure' refers to expenditure for management and lease fees that are otherwise allowable under section 8-1 whose 'eligible service period' ends not more than 13 months after being incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

The project manager will inform affected taxpayers of the number of days in the eligible service period in the expenditure year. This figure is necessary for the deduction for management fees to be calculated.

PR 2000/71**Year 1: Expenditure incurred on or before 30 June 2000**

Available deduction = A + B

Where:

$$A = \frac{\text{Expenditure X} \times \text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$B = (\text{Expenditure less A}) \times 80\%$$

Year 2: Expenditure incurred on or after 1 July 2000 and on or before 30 June 2001

Available deduction = A + B+C

Where:

$$A = \frac{\text{Expenditure X} \times \text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$B = (\text{Expenditure less A}) \times 60\%$$

$$C = \text{balance of the Year 1 expenditure not previously deducted.}$$

Year 3: Expenditure incurred on or after 1 July 2001 and on or before 30 June 2002

Available deduction = A + B+C

Where:

$$A = \frac{\text{Expenditure X} \times \text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$B = (\text{Expenditure less A}) \times 40\%$$

$$C = \text{balance of the Year 2 expenditure not previously deducted.}$$

41. For a Grower who invests in the Project on or before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, deductions other than the Preparation and Planting fees are shown in the Table below:

Fee type	ITAA 1997 Section	Deductions for taxpayers who are not small business taxpayers. Per Hectare.		
		Year 1	Year 2	Year 3
		30/6/2000	30/6/2001	30/6/2002
Lease Fees	8-1	\$200 see note (i) below	\$200	\$200
Annual Maintenance Fee	8-1		\$100	\$100

(All figures shown are exclusive of GST)

Note:

- (ii) Amounts of less than \$1,000 will be ‘excluded expenditure’ as defined in section 82KZL(1) and are deductible in full in the year in which they are incurred. Where these amounts exceed \$1,000, as may be the case where a Grower has more than one interest in the Project, deductions are determined on the same basis as shown above for prepaid management fees.

Division 35 – Deferral of losses from non-commercial business activities

Section 35-55 – Commissioner’s discretion

41.1 For a Grower who is an individual and who entered the Project between 14 June 2000 and 30 June 2000 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 has decided for the income years ended 30 June 2001 to 30 June 2015 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

- the exception in subsection 35-10(4) applies;
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or

- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

41.3 Where, the exception in subsection 35-10(4) applies, the Grower's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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, ie, 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.

41.4 Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

Sections 82KL, 82KZM, 82KZMB and Part IVA

42. For a Grower who invests in the Project the following provisions have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable;
- expenditure by Growers who are small business taxpayers is not within the scope of section 82KZM;
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business; and
- 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.

Proposed new laws

Proposed changes to prepayment rules

43. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of certain agreements. Legislation introduced into Parliament, but not yet enacted, provides that these changes will not apply if the relevant expenditure falls within one of the Exceptions to

the proposed provisions. Provided the provisions are enacted as introduced, expenditure incurred by investors in this Project will be within Exception 5 to proposed section 82KZME.

44. Where Exception 5 applies to expenditure that has an 'eligible service period' ending not more than 13 months after the expenditure is incurred and is deductible under section 8-1:

- deductions for 'small business taxpayers' will be allowable in full in the year that the expenditure is incurred; and
- the amount and timing of deductions for taxpayers who are not 'small business taxpayers' will be determined under sections 82KZMB and 82KZMC of the ITAA 1936.

45. The practical effect of expenditure being within Exception 5 is that the deductions described in paragraphs 37 to 40 of this Product Ruling will not be affected by the proposed changes to the prepayment rules.

Explanations

Assessability of income from the project

46. For a Grower who invests in the Project any income received by them from the sale of their timber will be assessable income to them under section 6-5.

Sections 27-5 and 27-30 - Goods and Services Tax

47. Section 27-30 of the ITAA 1997 operates to deny a deduction that would be otherwise available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled on or after 1 July 2000.

48. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (on or after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Grower has.

Section 8-1

49. Consideration of whether fees payable under the Lease and Forest Management 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) determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

50. 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.

51. 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.

52. For this Project Growers have, under the Lease and Forestry Management 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 the Lease and Forestry Management Agreements, Growers appoint WFL, as Manager, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers control their investment. The specific cost to the Grower of these services provided during the preparation and planting period will total \$5,000. Growers may both collect the forest produce and arrange

for its sale or they have the option of WFL arranging marketing and sale in return for a proportion of the proceeds.

53. The Lease and Forestry Management Agreement gives Growers full right, title and interest in the Forest Produce and the right to have the Forest Produce sold for their benefit. The relevant documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees belong to the Growers in the sense that they have an interest in the land on which they are growing and a profit à prendre in respect of the timber produce, which confers an equitable interest in the trees upon the Grower.

54. Growers have the right to use the land in question for afforestation purposes and to have WFL come onto the land to carry out its obligations under the Lease and Forestry Management Agreements. The Growers' degree of control over WFL, 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 WFL's activities. Growers are able to terminate arrangements with WFL in certain instances, such as cases of default or neglect. The afforestation activities described in the Lease and Forestry Management Agreements are carried out on the Growers' behalf.

55. 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 Project is realistic and commercially viable. 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.

56. 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.

57. 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.

58. The fees associated with the afforestation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the

sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. 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.

Subdivision 960-Q - Small business taxpayers

59. In this Product Ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure and the depreciation of trellising.

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

61. 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.

62. '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).

Section 82KL

63. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefit(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.

Section 82KZM - Prepaid expenditure for 'small business taxpayers'

64. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly to be done within 13 months after the day on which the expenditure is incurred.

65. Under Part 1 of the Forestry Management Agreement the Preparation and Planting Fee of \$5,000 per Hectare 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.

66. Thus, for the purposes of this Ruling, it is accepted that no part of the Preparation and Planting Fee of \$5,000 is for the doing of 'things' that is not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure of \$5,000 by Grower who are 'small business taxpayers'.

Sections 82KZMA - 82KZMD - Prepaid expenditure for taxpayers other than small business taxpayers

67. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred ('the expenditure year'). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

68. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project, transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to the Project.

69. The deduction available to Growers for the management fee will be determined in accordance with the rules contained in section 82KZMB. Because the quantum of the management fee is the same or lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available.

70. During the transitional period the amount of the deduction available to Growers is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

71. The changes announced by the Government, but not yet enacted, to apply from 11 November 1999 will affect all taxpayers that participate in certain agreements and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 will be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

72. However, those changes will not apply where the expenditure incurred under the agreement is within one of the Exceptions to the proposed provisions.

73. Exception 5 provides that the expenditure must not be under an agreement to which a Product Ruling applies, describing expenditure under the agreement as being allowable as a deduction. The product ruling must be made:

- (a) on or before 1 pm (by legal time in the Australian Capital Territory) on 11 November 1999; or
- (b) in response to an application for a Product Ruling where:
 - the application was received by the Commissioner on or before the time specified in paragraph (a); and
- (c) the Commissioner acknowledged receiving the application.

74. This Product Ruling is made in response to an application received by the Commissioner on or before 1 pm on 11 November 1999 and acknowledged. Expenditure incurred by investors in the Project will, therefore, be within Exception 5 if the proposed new law is enacted as introduced into parliament.

Interest

75. Some Growers may intend to finance their 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 lease and forest management fees incurred per hectare would be deductible. The interest fees incurred 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.

Part IVA

76. 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). Willmott Forests - 2000 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 \$5,000 per Hectare, 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.

77. 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 \$5,000 or the annual fees of \$300 being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Example

78. Example 1: Obligation to prepay expenditure arising on or after 11:45am AEST 21 September 1999 and before 1pm AEST 11 November 1999 – applies to taxpayers who are not small business taxpayers and are carrying on a business:

Joseph Gardener enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable in advance on 1 June each year for services to be provided for the following 12 months, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of \$4,899 for expenditure incurred on or before 30 June 2000 on management fees. This amount is calculated as A + B where:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$= \$6,000 \times \frac{30}{365} = \$493$$

$$B = (\text{Management fee less } A) \times 80\%$$

$$= (\$6,000 - \$493) \times 80\% = \$4,406$$

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e., \$1,101 is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of \$1,861 as expenditure incurred on or after 1 July 2000 and on or before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 60\% = \$661$$

$$C = \$1,101$$

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the \$1,200 management fees prepaid on 1 June 2001 (i.e., \$440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with Product Rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, for 2001/2002, Joseph can claim a deduction of \$980 for expenditure incurred on or after 1 July 2001 and on or before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 40\% = \$441$$

$$C = \$440$$

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the

\$1,200 management fees prepaid on 1 June 2002 (i.e., \$660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

Detailed contents list

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Related Rulings/Determinations:

TR 92/1; TR 92/20; TD 93/34;
 TR 97/11; TR 97/16; TR 98/22;
 PR 1999/95; PR 2000/3;

Subject references:

- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- interest expenses
- management fees expenses
- plantation forestry
- primary production
- primary production expenses

- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- timber industry

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82 KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC

- ITAA 1936 82KZMD
 - ITAA 1936 Pt IVA
 - ITAA 1936 177A
 - ITAA 1936 177C
 - ITAA 1936 177D
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 - ITAA 1997 27-5
 - ITAA 1997 27-30
 - ITAA 1997 Div 35
 - ITAA 1997 35-10
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 - ITAA 1997 35-55
 - ITAA 1997 35-55(1)
 - ITAA 1997 35-55(1)(b)
 - ITAA 1997 35-55(2)
 - ITAA 1997 Subdiv 960-Q
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