



PR 2000/98 - Income tax: 2001 Timbercorp Eucalypts Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 November 2000*



Product Ruling

Income tax: 2001 Timbercorp Eucalypts Project

Contents	Para
What this Product Ruling is about	1
Date of effect	12
Withdrawal	14
Arrangement	15
Ruling	38
Explanations	47
Examples	99
Detailed contents list	100

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 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

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.

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 law(s)' identified below apply to the defined class of persons, who take part in the arrangements to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 2001 Timbercorp Eucalypts 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* (ITAA 1997);
- section 8-1 (ITAA 1997);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- sections 82KJ, 82KK and 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- sections 82KZM and 82KZMB - 82KZMD (ITAA 1936);
- sections 82KZME - 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 the Ruling.

10. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangements entered into are not the arrangements ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 13 September 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).

13. 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

14. 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 arrangements during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangements or in the persons' involvement in the arrangements.

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 2 June 2000;

- Draft **Prospectus** prepared for Timbercorp Securities Limited A.C.N. 092 311 469 (“Timbercorp Securities”), dated 2 June 2000;
- Final revised draft copy of **Management Agreement** between each Grower and Timbercorp Securities, undated, received on 28 August 2000;
- Draft copy of **Sub Lease (WA) Agreement** between each Grower and Timbercorp Securities, dated 2 June 2000;
- Draft copy of **Sub Lease (Vic) Agreement** between each Grower and Timbercorp Securities, dated 2 June 2000;
- Draft copy of **Sub Lease (SA) Agreement** between each Grower and Timbercorp Securities, dated 2 June 2000;
- Final revised draft copy of Plantation Services Agreement between Timbercorp Securities and Timbercorp Treefarms Pty Ltd, dated 31 May 2000, received on 28 August 2000;
- Draft Custody Agreement between Timbercorp Securities and Permanent Trustee Company Ltd, dated 10 July 2000, received 19 July 2000;
- Draft copy of the **Constitution** establishing the Project, undated, received on 2 June 2000;
- Draft Timbercorp Eucalypts Project **Finance Package** undated, received on 2 June 2000;
- Letter and attachments to ATO from Timbercorp Securities, dated 26 July 2000;
- Facsimile and attachments to ATO from Timbercorp Securities, dated 16 August 2000;
- Facsimile and attachments to ATO from Timbercorp Securities, dated 22 August 2000;
- Facsimile to ATO from Timbercorp Securities, dated 23 August 2000;
- Letter and attachments to ATO from Timbercorp Securities, dated 28 August 2000; and
- Facsimile to ATO from Timbercorp Securities, dated 4 September 2000.

PR 2000/98

Note: certain information 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 Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called the 2001 Timbercorp Eucalypts Project.

Location	SouthWest Western Australia, Western Victoria and South East South Australia.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Eucalyptus globulus</i> trees (Tasmania Blue Gum) for the purpose of producing timber for wood chipping and for manufacture into premium quality paper.
Number of hectares under cultivation	8,000 hectares.
Names used to describe the product	The 2001 Timbercorp Eucalypts Project
Size of each Woodlot	1 to 1.2 hectares with a minimum subscription of 3 Woodlots
Number of trees per hectare	Between 833 and 1,250
Expected production	A yield of 300 cubic metres of timber per Woodlot
The term of the investment in years	8-12 years
Initial Fees per minimum subscription of three Woodlots	\$12,210
Initial Fees per Woodlot	\$4,070
Second year Fees per Woodlot	\$165
Ongoing annual costs commencing 1 July 2001	<ul style="list-style-type: none"> Rental (\$302.50 per Woodlot indexed for CPI annually).

	<ul style="list-style-type: none"> • Forest Maintenance Fee (\$82.50 per Woodlot indexed for CPI annually). • Insurance (if choose to insure).
Other costs	<ul style="list-style-type: none"> • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, the prescribed proportion of the harvest, delivery and other costs. • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, a harvest supervision /management fee of 3.25% of the net proceeds payable to the Grower. • An amount equal to 1/3 of net proceeds payable to the Grower in excess of net sale proceeds of \$14,285 per Woodlot forecast in the Prospectus less allowance for inflation and indexed for CPI. • An amount equal to 1/3 of net proceeds from the sale of Carbon Credits.
Other Features	<ul style="list-style-type: none"> • There is an opportunity for Growers to participate in a second rotation.

18. The 2001 Timbercorp Eucalypts Project will be registered as a managed investment scheme under the Corporations Law. Growers entering into the Project will sublease land from Timbercorp Securities, in Victoria, South Australia or in Western Australia. The sublease is for a term expiring on the earlier of 30 June 2014 or the completion of harvesting. The minimum area of land leased by each Grower is three identifiable allotments of land of between one and 1.2 hectares which are referred to as Woodlots.

19. There are 8,000 Woodlots on offer at an initial cost of \$4,070 per Woodlot. There is an option to accept oversubscriptions. Timbercorp Securities, as the Responsible Entity and project manager does not propose to accept subscriptions to the Project after 31 May 2001. It is therefore expected that all Agreements, to which each several Grower will enter into or become a party to, will be executed on or before 31 May 2001.

20. The Growers will enter into a Management Agreement with Timbercorp Securities to have a Tasmanian Blue Gum (*Eucalyptus globulus*) plantation established on this leased land for the purpose of eventual felling and sale in 8-12 years. Seedling stocking rate is

between 833 and 1,250 trees per hectare. There is the opportunity to participate in a second rotation.

21. The Project will also allow two Growers to enter into a joint venture. They will be bound by the Terms and Conditions of the Joint Venture set out in the Application Form attached to the Draft Prospectus of the Project.

22. Under this Joint Venture:

- a first Joint Venture Grower will be responsible for procuring the preparation and establishment of the Woodlots; and
- a second Joint Venture Grower will be responsible for procuring the ongoing provision of land and maintenance (cls 4(a) & (b), Terms and Conditions of the Joint Venture).

23. The Terms and Conditions of the Joint Venture provide that each joint venturer will be entitled to a separate, discrete share of the wood to be sold. (cls 5(a) & (b)).

Management Agreement

24. Growers contract with Timbercorp Securities to establish and maintain the plantation until maturity (cl 6) and to harvest and sell the wood on their behalf (cls 7, 8). The services provided include acquiring seedlings on behalf of Growers, establishing and maintaining the trees, constructing and maintaining firebreaks, repairing damage to roads and fences, preventing and combating degradation of the Woodlots and taking out public risk insurance (cl 6(b)).

25. Growers execute a Power of Attorney enabling Timbercorp Securities to act on their behalf in entering any agreement for the sale of the Grower's wood (cl 7).

26. Under the financial hardship provision, Growers can apply to have their remaining annual rent and maintenance fees from year 6 paid by Timbercorp Securities in return for 5% of their sale proceeds for each year in which the costs are paid by Timbercorp Securities (cl 12). Growers are not entitled to assign the Management Agreement except in certain circumstances (cl 24).

Sub Lease Agreements

27. Growers enter into a Sub Lease Agreement with Timbercorp Securities as sub-lessor. The Sub Lease Agreement is conditional upon the Grower entering into the Management Agreement (cl 4.2). It

is also conditional upon Timbercorp Securities receiving approval from the WA Planning Commission (in respect of land in Western Australia) and any local, state or Commonwealth government approvals, if required (cl 4.1). Clause 13 of each Sub Lease Agreement grants an interest in the land to the Grower. Growers are not entitled to assign the Sub Lease Agreement except in certain circumstances (cl 18.10).

Fees

28. Having regard to the contractual terms of the Management and Sub Lease Agreements, the fees payable by a Grower per Woodlot will be as follows:

- \$3,932.50 plantation preparation and establishment fee payable in two instalments. \$3,767.50 for services provided in the period ending 30 June 2001 is payable on lodging the Application and the balance of \$165 for services provided in the period ending 30 June 2002 is payable on 31 October 2001;
- \$302.50 land rental fee for the period ending 30 June 2001 payable on lodging the Application. Thereafter, the land rental fee is \$302.50 per Woodlot p.a. payable on 31 October of each year. This fee will be reviewed each year to the greater of the previous year's rent or indexed using a formula based on CPI increases and will be payable in respect of each year commencing on 1 July and expiring on the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance); and
- \$82.50 forest maintenance fee indexed, payable on 31 October of each year in respect of the period 1 July to the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance).

29. Timbercorp Securities will endeavour to arrange fire insurance, with premiums anticipated to be approximately \$11 per Woodlot in the first year increasing to some \$72 per Woodlot at maturity.

30. Timbercorp Securities has appointed a custodian to receive application moneys and ensure those moneys are applied in accordance with the agreements. Timbercorp Securities will pay the custodian fees.

Establishment and Maintenance of the Plantation

31. The Draft Prospectus of the Project states that the Woodlots will be prepared for planting by 30 June 2001 and will be planted in the income year ending 30 June 2002. The Independent Forester's Report sets out the details of the plantation establishment and management activities to be undertaken. These include, among others, selection of seed, seedlings, site preparation, planting method, subsequent plantation care and silvicultural tending of the plantation. The Management Plan provides a timetable when these activities will be undertaken. Timbercorp Securities will sub-contract all plantation establishment and maintenance functions to Timbercorp Treefarms Pty Ltd, a related company. Timbercorp Securities will provide ongoing reports to the Growers on the progress of the plantations.

32. The harvest period is between 30 September 2009 and 30 September 2013. Timbercorp Securities will be responsible for arranging the marketing; harvesting and sale of the wood, with the Grower kept informed of the details, including proposed purchase price and harvesting and delivery costs.

Finance

33. Growers can fund their investment in the Projects themselves, borrow from Timbercorp Finance Pty Ltd (a lender associated with the Responsible Entity) or borrow from an independent lender.

34. The finance to be offered by Timbercorp Finance Pty Ltd is available to a maximum of \$3,250 per Woodlot. The interest rate depends on the term of the loan. Security is over the Grower's interest in the Project, i.e., the Woodlots and the entitlement to wood proceeds. The loan is repayable by equal monthly instalments of principal and interest and is provided on a full recourse basis. Legal action will be taken over any outstanding repayments.

35. The custodian will be custodian of the application moneys, including loan funds if the finance option is taken, and ensure those moneys are applied in accordance with the agreements.

36. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution other than Timbercorp Finance Pty Ltd for the provision of any finance to the Growers for any purpose associated with the Project.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;

- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrowers risk;
- ‘additional benefits’ are or 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 or rate of interest is non-arms length;
- 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, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project, other than Timbercorp Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Section 6-5: Assessable Income

38. 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 97. Section 17-5 ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Section 8-1: Allowable Deductions

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

39. A Grower (who is not a joint venture grower) may claim tax deductions in the Table below where the Grower:

- participates in the project on or before 31 May 2001 to carry on the business of afforestation;

PR 2000/98

- incurs the fees shown in paragraph 28; and
- is not registered or is not required to be registered for GST.

Deductions available each year per Woodlot

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Plantation preparation & establishment fee	8-1	\$3,767.50 – see note (i) below	\$165 – see note (i) below	nil
Rent	8-1	\$302.50 – see note (i) below	\$302.50 – see note (i) & (iii) below	\$302.50 – see note (i) & (iii) below
Annual maintenance fee	8-1	Nil	\$82.50 – see note (i) & (iii) below	\$82.50 – see note (i) & (iii) below
Interest on borrowed funds	8-1	As incurred – see note (ii) below	As incurred – see note (ii) below	As incurred – see note (ii) below
Insurance	8-1	As incurred	As incurred	As incurred

Notes:

- (i) Where a Grower incurs the management fees and the lease fees as required by the Management Agreement and the Sub 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 (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 63 to 67 unless the expenditure is ‘excluded expenditure’. ‘Excluded expenditure’, being expenditure of less than \$1,000, is an ‘exception’ to any prepayment rules that apply and is deductible in full in the year in which it is incurred.
- (ii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than

Timbercorp Finance Pty Ltd is outside the scope of this Ruling. However, Growers should read carefully the discussion of the prepayment rules in paragraphs 72 to 74 below, as those rules may be applicable if interest is prepaid.

(iii) These amounts do not allow for indexation.

40. A joint venture Grower may claim the following tax deductions where the joint venture Grower:

- participates in the project on or before 31 May 2001 to carry on the business of afforestation;
- incurs the relevant fees shown in paragraph 28; and
- is not registered or is not required to be registered for GST.
 - (i) for the first joint venture Grower, fees as per the Table at paragraph 39 in relation to plantation preparation and establishment and interest on borrowed funds; and
 - (ii) for the second joint venture Grower, fees as per the Table at paragraph 39 in relation to rent, annual maintenance, insurance and interest on borrowed funds.

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

41. Where a Grower (who is not a joint venture grower) who is registered or required to be registered for GST:

- participates in the project on or before 31 May 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 28; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Table at paragraph 39 will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 99.

42. Where a joint venture Grower who is registered or required to be registered for GST:

- participates in the project on or before 31 May 2001 to carry on the business of afforestation;
- incurs the relevant fees shown in paragraph 28; and

- is entitled to an input tax credit for the fees

then the deductions advised at paragraph 40 will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 99.

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

43. 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 2009 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.

44. 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 79 in the Explanations part of this ruling, below).

45. 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.

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

46. For a Grower who invests in the Project the following provisions of the ITAA 1936 have application as indicated:

- (i) section 82KJ will not apply to deny a deduction otherwise allowable under section 8-1;
- (ii) provided Growers do not fall within the definition of associates of the Responsible Entity, section 82KK will not apply to deny a deduction otherwise allowable under section 8-1;

- (iii) section 82KL does not apply to deny the deductions otherwise allowable;
- (iv) expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 60 to 67);
- (v) expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 60 to 67);
- (vi) expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 60 to 67); and
- (vii) 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.

Explanations

Subdivision 960-Q: Small business taxpayers

47. 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.

48. '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).

49. 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'.

Section 8-1: Allowable Deductions

50. Consideration of whether the lease and management fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;

- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is a taxpayer contractually commits 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 outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

51. 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 Project, 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.

52. 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.

53. For this Project Growers have, under the Sub Lease, 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 Management Agreement, Growers appoint Timbercorp Securities, as Responsible Entity and Project 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.

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

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

56. 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.

57. 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.

58. 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.

59. 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. The fees 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. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF

60. The prepayments 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. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

61. In this Project, the Management Fee of \$3,767.50 and a Sub Lease Fee of \$302.50 per Woodlot will be incurred on execution of the Management Agreement and the Sub Lease Agreement. The Management Fee and the Sub Lease Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

62. There is also no evidence that might suggest the management services covered by the fee could not be provided within 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 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 28, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

Growers who choose to pay fees for a period in excess of that required by the Project’s agreements

63. Although not required under either the Management Agreement or the Sub Lease Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 62 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

64. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Sub Lease Fees otherwise deductible under section 8-1 will depend upon 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. 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'.

65. 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.

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

66. 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 a 'small business taxpayer' (see paragraphs 47 to 49) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same or effectively the same as that shown in paragraph 65 above, concerning section 82KZMF.

67. A prepaid management fee and/or a prepaid lease fee of less than \$1,000 incurred in an 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 a prepaid management fee or a prepaid lease fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider

68. Growers may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd.

69. 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. As the loan facility offered by Timbercorp Finance Pty Ltd does not require a Grower to prepay interest, section 82KZME or 82KZMF will not apply. The interest will be deductible in full in the year in which it is incurred.

70. However, a Grower who, contrary to the requirements of the loan contracts offered by Timbercorp Finance Pty Ltd, chooses to prepay interest will be required to determine any tax deduction under the prepayment provisions of the ITAA.

71. Therefore, unless the prepaid interest is 'excluded expenditure', where a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 65 above.

(ii) Growers who DO NOT use Timbercorp Finance Pty Ltd as the finance provider

72. 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 Timbercorp 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.

73. 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 or a Grower may choose to prepay interest. Under the prepayment rules contained in section 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project, not described in the Arrangement or otherwise dealt with in the Product Ruling.

74. As in paragraph 71 above, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to

be prepaid or a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 65 above.

Insurance deductibility

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

Division 35 - Losses from non-commercial business activities

76. 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.

77. 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.

78. 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.

79. 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.

80. 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).

81. 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 (comprising 3 Woodlots) in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2009. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

82. 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.

83. 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) until the year ended 30 June 2009.

84. 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.

85. 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 43), in the manner described in the Arrangement (see paragraphs 15 to 37), 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.

86. 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; and
- independent, objective, and generally available information relating to the afforestation industry.

Section 82KJ

87. Section 82KJ denies a deduction in respect of certain prepaid outgoings that are incurred as part of a tax avoidance agreement. Section 82KJ's operation depends, among other things, on the taxpayer acquiring, or being reasonably expected to acquire, property and the consideration for that property is less than that which might reasonably be expected to have been payable.

88. 'Property' is defined broadly and includes a chose in action and any estate, interest, right or power, whether at law or in equity, in or over property. The Grower's interest in the Project falls within this definition.

89. The consideration paid by the Growers in respect of the 'property' is not less than that which might reasonably be expected to have been payable. Section 82KJ will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KK

90. Section 82KK applies where a taxpayer incurs an allowable outgoing to an associate in an income year and the associate does not include that amount as assessable income until a subsequent year. Where the section applies, the outgoing is allowable to the taxpayer only in the year in which it is included in the assessable income of the associate.

91. Subsection 82KH(1) defines 'associate' broadly. The definition includes a company where the company or its directors are accustomed to or are under an obligation to act in accordance with the directions of the taxpayer, or where the taxpayer and associates might have the capacity to control the casting of more than 50% of the

maximum number of votes that could be cast at a general meeting of such a company.

92. Provided Growers do not fall within the definition of associates of the Responsible Entity, section 82KK will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KL

93. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'

94. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

95. Section 82KL's operation depends, among other things, on the identification of 'additional benefit(s)'. Here, there may be a loan provided by Timbercorp Finance Pty Ltd to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

96. 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).

97. The Timbercorp Eucalypts 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 28, 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.

98. 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. 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.

Examples

Example 1 – Entitlement to ‘input tax credit’

99. 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 which includes its ABN and shows the price of the taxable supply for management services (\$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

100. Below is a detailed contents list for this Product Ruling:

	Paragraph
What this Ruling is about	1
Tax law(s)	2
<i>Goods and Services Tax</i>	3
<i>Business Tax Reform</i>	4
<i>Note to promoters and advisers</i>	6
Class of persons	7
Qualifications	9

Date of effect	12
Withdrawal	14
Arrangement	15
Overview	17
Management Agreement	24
Sub Lease Agreements	27
Fees	28
Establishment and Maintenance of the Plantation	31
Finance	33
Ruling	38
Section 6-5: Assessable Income	38
Section 8-1: Allowable Deductions	39
Deductions where a Grower is not registered or not required to be registered for GST	39
Deductions where a Grower is registered or required to be registered for GST	41
Section 35-55 – Losses from non-commercial business activities	43
Section 82KJ, 82KK, 82KL, 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF and Part IVA	46
Explanations	47
Subdivision 960-Q: Small business taxpayers	47
Section 8-1: Allowable Deductions	50
Is the Grower carrying on a business?	51
Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF	60
<i>Growers who choose to pay fees for a period in excess of that required by the Project’s agreements</i>	63
Interest deductibility	68
<i>(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider</i>	68
<i>(ii) Growers who DO NOT use Timbercorp Finance Pty Ltd as the finance provider</i>	72
Insurance deductibility	75
Division 35 – Losses from non-commercial business activities	76
Section 82KJ	87

Section 82KK	90
Section 82KL	93
Part IVA	96
Examples	99
Example 1 – Entitlement to ‘input tax credit’	99
Detailed contents list	100

Commissioner of Taxation

13 September 2000

<i>Previous draft</i>	- ITAA 1936 82KZMD
Not previously issued in draft form	- ITAA 1936 82KZME
	- ITAA 1936 82KZMF
<i>Related Rulings/Determinations:</i>	- ITAA 1936 Pt IVA
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 177A
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1936 177C
PR 1999/95	- ITAA 1936 177D
	- ITAA 1936 177D(b)
<i>Subject references</i>	- ITAA 1997 6-5
- carrying on a business	- ITAA 1997 8-1
- commencement of business	- ITAA 1997 17-5
- fee expenses	- ITAA 1997 Div 27
- interest expenses	- ITAA 1997 27-5
- management fee expenses	- ITAA 1997 35-10
- producing assessable income	- ITAA 1997 35-10(2)
- product rulings	- ITAA 1997 35-10(3)
- public rulings	- ITAA 1997 35-10(4)
- schemes and shams	- ITAA 1997 35-30
- taxation administration	- ITAA 1997 35-35
- tax avoidance	- ITAA 1997 35-40
	- ITAA 1997 35-45
<i>Legislative references</i>	- ITAA 1997 35-55(1)
- ITAA 1936 82KH(1)	- ITAA 1997 35-55(1)(a)
- ITAA 1936 82KH(1F)(b)	- ITAA 1997 35-55(1)(b)
- ITAA 1936 82KJ	- ITAA 1997 960-335
- ITAA 1936 82KK	- ITAA 1997 960-340
- ITAA 1936 82KL	- ITAA 1997 960-345
- ITAA 1936 82KZM	- ITAA 1997 960-350
- ITAA 1936 82KZM(1)	- TAA 1953 Pt IVA
- ITAA 1936 82KZMB	- Copyright Act 1968
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