



PR 2001/114 - Income tax: Kimseed Robin Downs 1994 Project

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Product Ruling

Income tax: Kimseed Robin Downs 1994 Project

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Preamble

The number, subject heading, and the *What this Product Ruling is about* (including *Tax law(s)*, *Class of persons* and *Qualifications* sections), *Date of effect*, *Withdrawal*, *Arrangement* and *Ruling* parts of this document are a 'public ruling' in terms of Part IVAAA of the *Taxation Administration Act 1953*. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.

No guarantee of commercial success

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 arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Kimseed Robin Downs 1994 Project', or just simply as 'the Project'.

Tax law(s)

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the 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 participating 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 these. 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 entered into the arrangement described below with a Commencement Date of 30 June 1994. They 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 have terminated or 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. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 33) 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

12. This Ruling applies prospectively from 29 June 2001, 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 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who entered into the specified arrangement. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

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 20 December 2000;
- **Lease and Management Agreement between Kimseed Pty Ltd ('the Manager'), the landowner ('the Lessor') and the Grower;**
- **Loan Agreement between Australian Revegetation Corporation Ltd ('the Lender') and the Grower ('the Borrower');**
- Introductory Letter, undated, from Kimseed Pty Ltd to prospective Growers, headed 'Kimseed Bluegum Plantation'; and
- additional correspondence received from the Applicant dated 17 March 1999, 24 March 1999, 10 May 1999, 26 May 1999, 31 May 1999, 14 June 2001 and 15 June 2001.

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 the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, that are part of the arrangement to which this Ruling applies. The effect of the agreements listed above is summarised as follows.

Overview

17. This arrangement is called the Kimseed Robin Downs 1994 Project. The salient features are:

Location	Robin Downs, east of Esperance in Western Australia
Type of business each participant is carrying on	Commercial growing of <i>Eucalyptus globulus</i> for the purpose of harvesting and sale
Size of each Woodlot	1 hectare
Number of trees per hectare	Establishment rate of 1,000 per hectare after the Initial Period
Expected production	250 cubic metres per hectare
Term of the investment	Approximately 11 years
Initial cost per hectare	\$3,950
Ongoing costs	Lease and management fees payable from net harvest proceeds
Other costs	Annual insurance premiums

18. This Project involves the planting of *Eucalyptus globulus* trees (Tasmanian Blue Gum) upon land held by the Lessor and located near Esperance, Western Australia. Growers who entered into the Project lease the land from the Lessor for a period of not more than 11 years from the Commencement Date of 30 June 1994. The leased area is known as a 'Woodlot'. Each Woodlot is 1 hectare in size.

19. Under the Lease and Management Agreement, Growers contract with the Manager for the cultivation of their leased area, and the planting and maintenance of trees.

20. The Manager will decide when the trees are mature and ready to be harvested. Unless the Grower has elected to take possession of their timber ('Participating Grower'), the Manager is authorised under the Lease and Management Agreement to harvest and sell the timber

on behalf of the Grower ('Non-participating Grower') at prevailing market prices at the time of harvest. The timber has not been pre-sold and the Manager will decide to whom it will be sold.

Lease and Management Agreement

21. Growers participating in the Project are granted an interest in land by the Lessor (set out in the Schedule attached to the Lease and Management Agreement) to use their Woodlots for the purpose of conducting their afforestation business. The Grower:

- will cultivate and maintain the leased area for the purpose of creating and developing a plantation in a proper and efficient manner according to sound silvicultural and environmental practices adopted within the forestry industry;
- is entitled to harvest the timber produce on the leased area, but is not entitled to any coppice after the first harvest of the trees; and
- is not entitled to use the leased area for permanent or temporary residential purposes.

22. The Grower, on agreeing to observe the Grower's Covenants, may peaceably possess the leased area during the term of the lease. At the expiration of the lease, the Grower will vacate the leased area.

23. The Agreement provides that each Grower appoints the Manager to establish and maintain the plantation on the Grower's leased area. The services to be performed by the Manager are specified in clause 4 of the Agreement. The Manager is required to plant *Eucalyptus globulus* seedlings of appropriate size on the leased area as soon as practicable in the first planting season after, and within 13 months of, the Commencement Date of the lease. The seedlings are to be planted at a density of at least 1,100 trees per hectare.

24. If, at the end of 12 months from the commencement of the lease, the planting fails to achieve an average survival rate of 1,000 stems per hectare, the Manager was to replace, at its expense, those seedlings that did not survive, to achieve an overall establishment of at least 1,000 stems per hectare.

25. For the remainder of the Lease and Management Agreement, the Manager will maintain the Grower's leased area in a proper and skilful manner and according to sound silvicultural and environmental practices and has access to the staff, consultants and other specialist services necessary to perform the services.

Fees

26. The fees payable under the Lease and Management Agreement on a per Woodlot basis are as follows:

- \$3,950 payable on Application for the first thirteen (13) months of the Term from the Commencement Date;
- At harvest, the Grower is required to pay an amount equal to 5.5% of the Net Sale Proceeds of the harvest in consideration of the Manager meeting the ongoing management and maintenance expenses after the first thirteen months of the Term;
- At harvest, the Grower is required to pay an amount equal to 4.4% of the Net Sale Proceeds of the harvest for Rent during the term of the Agreement.

27. At the expense of the Grower, the Manager will take out insurance cover in respect of the Grower's interest and obligations against damage or destruction of the leased area and its improvements by fire and/or the other usual risks. The Manager is entitled to an additional 10% on the cost of the premium.

Harvesting and Sale

28. Harvesting is to take place when the Plantation is judged by the Manager to be mature. The Manager will give a Project Maturity Notice to the Grower stating that the trees on the Plantation are judged to be mature (clause 8.2 of the Lease and Management Agreement).

29. Growers will share the Gross Sales Proceeds on a proportionate basis following the payment of harvesting costs and costs of sale, and any amounts due and payable by the relevant Grower.

30. If a Grower is a 'Participating Grower' (clauses 1 and 8), the Grower must, one month prior to harvesting, pay the Manager's estimate of the Management Fee and the Lessor's estimate of the Rent. The Grower must also notify the Manager and Lessor in writing of the Gross Sales Proceeds and pay to the Manager and the Lessor respectively the excess (if any) between the estimated and actual Management Fee and Rent.

Finance

31. Growers can fund the investment themselves or borrow from an independent lender. Finance is also available through Australian Revegetation Corporation Ltd. This arrangement will be as follows:

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- the Grower pays 20% of the initial management fee on application;
- the Grower may borrow the remaining 80% of the initial management fee;
- interest on the loan is charged at the rate of 10% pa and is to be paid in advance by 30 June 1999;
- repayments of principal are to be made in instalments on five pre-set dates between 1 October 1999 and 1 April 2000;
- the term of the loan is 9 months; and
- Australian Revegetation Corporation Ltd has full recourse to the Grower and the loan will be secured by a mortgage over the Grower's Project interest.

32. The borrower's obligation to pay Australian Revegetation Corporation Ltd interest and repay the loan is absolute and is not limited to the proceeds of harvest. In addition, if the borrower defaults on the loan, all of the secured monies (all amounts now or at any time in the future owing, comprising the Principal sum, all interest and all other fees owing under the loan) immediately become payable. Legal action will be taken to recover any outstanding payments.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project, other than Australian Revegetation Corporation Ltd, are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be

- transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Division 35 - deferral of losses from non-commercial business activities

Section 35-55 - Commissioner's discretion

34. For a Grower who is an individual and who entered the 1994 Project, the rule in section 35-10 may apply to the business activity comprised by their involvement in the Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2004 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.

35. 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 41 in the Explanations part of this Ruling, below).

36. 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 the 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.

37. 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 subsection 35-55(1) 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 this perspective has not been made.

Explanations

Division 35 - deferral of losses from non-commercial business activities

38. 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.

39. 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.

40. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

41. 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.

42. 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).

43. A Grower who was accepted into and commenced participation in the 1994 Project is 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 Woodlot in the Project is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2005.

44. 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.

45. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the years ended 30 June 2001 to 30 June 2004.

46. 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.

47. Information provided by the Applicant states that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on, in a manner that is not materially different to that described in the Arrangement in this Product Ruling.

48. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report of the Independent Forester and additional evidence provided with the application by the Applicant;
- the financial projections contained in the Prospectus; and

- independent, objective and generally available information relating to the plantation timber industry.

Detailed contents list

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Previous draft:

Not previously issued in draft form

- tax shelters
- tax shelters project

*Related Rulings/Determinations:*PR 1999/95; TR 92/1; TR 92/20;
TR 97/16; TD 93/34; TR 98/22*Legislative references:*

- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1936 82KL
- ITAA 1936 Part IVA

Subject references:

- carrying on a business
 - commencement of business
 - fee expenses
 - interest expenses
 - management fees
 - producing assessable income
 - product rulings
 - public rulings
 - taxation administration
 - tax avoidance
 - tax benefits under tax avoidance schemes
-

ATO references:

NO

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