



# ***PR 2001/119 - Income tax: Queensland Paulownia Forests Project No. 4***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 June 2001*



## Product Ruling

### Income tax: Queensland Paulownia Forests Project No. 4

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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.

#### *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

The Australian Taxation Office (ATO) **does not** sanction or guarantee these products as investments. Further, we give no assurance that the products are 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 products. 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 Queensland Paulownia Forests Project No 4, or simply as 'the Project'.

### Tax law(s)

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

### 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 entered into the arrangement described below between 17 November 1999 and 30 June 2000. They will have had 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 the Project.

### **Qualifications**

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

10. If the arrangement described in this 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**

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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

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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 enter into the specified arrangement on or after 17 November 1999 and not before 30 June 2000. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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

- Application for a Product Ruling from Queensland Paulownia Forests Ltd (QPFL) dated 19 August 1999 in respect of Queensland Paulownia Forests Ltd Project No.4;
- Prospectus issued by Queensland Paulownia Forests Ltd, dated 13 August 1999;
- Constitution of Queensland Paulownia Forests Ltd Project No.4 dated 16 March 1999, incorporating the Supplementary Constitution, dated 10 August 1999, ('the Constitution');
- Compliance Plan for the Queensland Paulownia Forests Ltd Project No.4 ('the Compliance Plan');
- **Farming Agreement** between Queensland Paulownia Forests Ltd and the Grower;

- **Finance Agreement** between Queensland Paulownia Forests Ltd and the Grower;
- **Plantation and Maintenance Agreement** between Queensland Paulownia Forests Ltd and the Grower;
- Term Sheet detailing terms in respect of a Personal Loan Facility from a nominated major bank;
- Letter of Agreement between nominated Finance Group and QPFL, dated 27/4/99;
- Consumer Credit Application for a personal loan from a nominated major bank;
- Draft Lease between Queensland Forestry Holdings Pty Ltd and Australian Rural Group Ltd;
- Draft Sub-Lease between Australian Rural Group Ltd and Queensland Paulownia Forests Ltd;
- Draft Sub-Lease between Queensland Forestry Holdings Pty Ltd and Queensland Paulownia Forests Ltd;
- Letter from QPFL dated 13 October 1999; and
- Letter of Application for Product Ruling for Queensland Paulownia Forests Project No. 4 dated 29 January 2001.

**NOTE: certain information received from Queensland Paulownia Forests Limited 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 that Growers entered 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, which are part of the arrangement to which this Ruling applies. The effect of these agreements is summarised as follows.

### **Overview**

17. This arrangement is called the Queensland Paulownia Forests Project No. 4.

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Location	“Austin Downs” Surat
Type of business each participant is carrying on	Commercial growing, and cultivation of Paulownia trees for the purpose of harvesting and selling timber.
Number of Woodlots on offer	6,000
Minimum number of Woodlots per application	2
Number of hectares available	1,200 hectares
Size of each Woodlot	0.2 hectares
Number of trees per Woodlot	52
Expected production	21 cubic metres of rough sawn timber or 32 cubic meters of timber in a round log form per Woodlot
Incentive fee	Responsible Entity will be entitled to 1/3 of revenue of timber yield in excess of the Projected Yield
The term of the investment	Until 30 June 2011.
Initial cost	\$4,995 per Woodlot
Initial cost per hectare	\$24,975
Ongoing costs	Management and Licence Fees.

18. This arrangement is called the Queensland Paulownia Forests Project No. 4. Growers who entered into the Project were to enter into a Farming Agreement that gave them a licence over an area of land called a ‘Woodlot’. The Land Owner (Queensland Forestry Holdings Pty Ltd) leases the land, at ‘Austin Downs’, Surat, to Australian Rural Group Ltd who subleases the land to QPFL who was to grant a licence to the Growers. The Growers were also to enter into a Plantation and Maintenance Agreement with QPFL to have certain paulownia trees (*paulownia fortunei*) planted on the Woodlot for the purpose of eventual felling and sale within approximately eight years.

19. There were 6,000 Woodlots on offer of 0.2 hectares each at a cost of \$4,995 per Woodlot. A Grower must have applied for a minimum of 2 Woodlots. The total land area for the Project was to be 1200 hectares although QPFL had the right to accept over subscriptions. A minimum of 52 trees per Woodlot (260 per hectare) were to be planted in the first 13 months following execution of the Plantation and Maintenance Agreement. Possible projected returns for Growers were outlined on pages 17 and 18 of the Prospectus. The projected returns depended on a range of assumptions and QPFL did not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into Plantation and Maintenance Agreements that were offered pursuant to

the Prospectus. Growers were to execute a power of attorney enabling QPFL to act on their behalf as required when they made an application for Woodlots.

### **Farming Agreement**

20. The Farming Agreement was to be entered into between QPFL and the Grower for each Woodlot. Growers were to be granted an interest in land in the form of a licence to use their Woodlot for the purpose of conducting their afforestation business (cl. 2.1). The Grower does not have a right of exclusive occupation of the Woodlot (cl. 2.2). The Growers must pay QPFL a Licence fee of \$150 per Woodlot per annum (cl. 6). This fee is indexed annually. The Manager must apply the Licence Fee to payment of rent under the sublease. The term of the Agreement is to 30 June 2011 or when Harvesting and Milling of all trees has been completed, whichever is the earlier (cl. 3.1). The Agreement is subject to the terms of the Constitution.

### **Plantation and Maintenance Agreement**

21. A Plantation and Maintenance Agreement was entered into between QPFL and the Grower for each Woodlot. The term of the Agreement is until 30 June 2011 or when Harvesting and Milling of all trees has been completed, whichever is the earlier (cl. 3.1).

22. Growers were to contract with QPFL to establish and maintain the plantation until maturity for an annual fee. During the first 13 months, QPFL will be responsible for planting *paulownia fortunei* on the Woodlot. From this period on, QPFL will maintain the trees in accordance with good silvicultural practice. The services to be provided by QPFL over the term of the Project are outlined in clause 4 of the Plantation and Maintenance Agreement. Growers may elect to collect their own Timber Attributable (cl. 9.1) or QPFL will sell the Timber Attributable on the Grower's behalf, for the best possible commercial price (cl. 6.2). Harvesting and Milling of Trees will take place between 30 June 2007 and 31 December 2007 or at another time as determined by QPFL (cl. 5).

23. For Non-Electing Growers the gross proceeds of sale of the Timber Attributable will be paid to the Responsible Entity in its capacity as Custodian of the project. The Responsible Entity will retain from the payment, the Grower's proportional interest of the Harvesting and Milling costs, other costs of sale, any outstanding fees owing by the Grower and the marketing fee. After payment of these expenses, the Responsible Entity will account to the Grower and pay the Grower his share of the gross proceeds of sale.



## **Constitution**

24. This Constitution is between QPFL, in its capacity as the Responsible Entity and Growers. QPFL also acts as Custodian for the project, and holds all Project Property. The Constitution sets out the terms and conditions under which QPFL agrees to act for the Growers and under which QPFL agrees to manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. QPFL keeps a register of Growers. Growers are entitled to assign the Plantation and Maintenance Agreement in certain circumstances (cl. 18). The Farming Agreement and the Plantation and Maintenance Agreement must have been entered through Applicants signing the Application and Limited Power of Attorney Form in the prospectus.

## **Fees**

25. The fees payable under clause 10 of the Plantation and Maintenance Agreement were:

- (i) \$4845 per Woodlot for the services provided in the first 13 months;
- (ii) \$175 per Woodlot per annum (indexed) commencing and payable 13 months after allocation of the Grower's Woodlot;
- (iii) an incentive fee calculated to be the gross sale proceeds of the Grower's timber multiplied by 1/3 of the amount of timber actually produced from the Woodlot over and above those estimates in the Prospectus for the Project;
- (iv) a marketing fee of not more than 5% of the gross proceeds generated from the sale of Timber Attributable to the Grower's Woodlot where QPFL sells on the Growers behalf.

26. The fee payable under clause 6 of the Farming Agreement was a Licence fee of \$150 per Woodlot per annum (indexed) commencing and payable on allocation of the Grower's Woodlot.

27. The Responsible Entity was to hold the application moneys in an application account to be released when certain specified criteria in the Constitution have been met (cl. 15).

**Finance**

28. Growers could have funded their investment in the Project themselves, borrowed from QPFL, or borrowed from a nominated major bank through finance organised through a nominated finance group.

29. Finance arrangements organised directly by a Grower with independent lenders are outside the arrangement to which this Ruling applies.

30. Where a Grower borrowed from QPFL, five finance options were offered:

- (a)
  - (i) \$500.00 per Woodlot upon signing of the Agreement ("first payment"), and
  - (ii) \$4,495.00 within 30 days (second payment) (the effective annual percentage rate of interest is 0%);
- (b)
  - (i) \$2,500.00 per Woodlot upon signing of the Agreement ("first payment"), and
  - (ii) \$2,670.00 within 60 days (second payment) (the effective annual percentage rate of interest is 7%);
- (c)
  - (i) \$500.00 per Woodlot upon signing of the Agreement ("first payment");
  - (ii) Twelve monthly investments of \$180.32 per Woodlot commencing 30 days from the signing of the agreement; and
  - (iii) A further payment of \$2,500.00 per Woodlot within 60 days upon the signing of the agreement (the effective annual percentage rate of interest is 11%);
- (d)
  - (i) \$500.00 per Woodlot upon signing of the Agreement ("first payment"), and
  - (ii) Twelve monthly investments of \$397.28 per Woodlot commencing 30 days from the signing of the agreement. (the effective annual percentage rate of interest is 11%);
- (e)
  - (i) \$500.00 per Woodlot upon signing of the Agreement ("first payment"), and
  - (ii) 24 monthly investments of \$211.60 per Woodlot commencing 30 days from the signing of the agreement. (the effective annual percentage rate of interest is 12%).

31. Clause 3.2 of the Finance Agreement provides, in respect of an Investment Option that involves payment of monthly instalments, that the first such instalment is due one month from the date of the Agreement, with subsequent instalments due monthly after that first due date.

32. Clause 5 of the Finance Agreement sets out the Lender's rights on default.

33. QPFL did have funds to lend to Growers. QPFL will have full recourse to the Borrower's assets should the Borrower (Grower) default, and it will pursue appropriate legal action against defaulting Growers. Funds borrowed from QPFL were to be paid direct to Application account, prior to a Grower being accepted into the Project. No round robin arrangements were to be involved and QPFL was to substantially use these funds, subject to authorisation by the Custodian Committee, in carrying out its obligations under the Plantation and Maintenance Agreement.

34. Where a Grower borrowed from a nominated major bank organised through a nominated finance group, they were to be subject to the terms and conditions in respect of a personal loan facility as set out in the Term Sheets provided by the Applicant. The loans facilitated through the Finance Group were to be on normal commercial terms; they were to be both in form and substance, full recourse, and borrowers were to be obliged to make the regular repayments regardless of any income being derived from the Project. Interest accrues monthly or fortnightly in arrears. Funds borrowed were to be paid direct to QPFL's Applicant account prior to a Grower being accepted into the Project.

35. 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;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's 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-arm's length;
- repayments of the principal and payments of 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;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than QPFL, are involved or become involved, in the provision of finance to Growers for the Project.

## **Ruling**

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

#### **Section 35-55 - Commissioner's discretion**

36. For a Grower who is an individual and who entered the Project on or after 17 November 1999 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 2007 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.

37. 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 43 in the Explanations part of this ruling, below).

38. 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.

39. 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 this perspective has not been made.

## **Explanations**

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

40. 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.

41. 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.

42. 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.

43. 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 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.

44. 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 is used on a continuing basis in carrying on the business activity in that year (section 35-45).

45. A Grower who was accepted into, and who has participated in the Project since 17 November 1999 is carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2008. Growers who acquired more than one interest in the Project may however, pass one of the tests in an earlier income year.

46. 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.

47. 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 acquired an interest(s) in the Project on or after 17 November 1999 and before 30 June 2000, the Commissioner has decided 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 2007.

48. 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.

49. 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.

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

- the report of the independent forestry expert and additional expert or scientific evidence provided by the Responsible Entity with the application and subsequently, in further information requested by the Commissioner;
- independent, objective, and generally available information relating to the paulownia industry.

## **Detailed contents list**

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

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**Commissioner of Taxation**

29 June 2001

*Previous draft:*

Not previously released in draft form

- tax benefits

- viticultural expenses

*Related Rulings/Determinations:*

TR 92/1; TR 97/11;  
 TR 97/16; TR 92/20; TR 98/22;  
 TD 93/34; PR 1999/95, PR 1999/100,  
 PR 2000/96;

*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 Pt IVA

*Subject references:*

- carrying on a business  
 - carrying on a business  
 - commencement of a business  
 - management fees  
 - primary production  
 - producing assessable income  
 - product rulings  
 - public rulings  
 - schemes  
 - tax avoidance

## ATO references:

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