



PR 2001/18 - Income tax: Pinetec Woodlot Project 2001

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 This document has changed over time. This is a consolidated version of the ruling which was published on *7 March 2001*



Product Ruling

Income tax: Pinetec Woodlot Project 2001

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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

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

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

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

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

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

Terms of Use of this Product Ruling

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

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Pinetec Woodlot Project 2001, or just simply as 'the Project'.

Tax law(s)

2. The tax laws 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);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMB - 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 agreement 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. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 47) 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 7 March 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 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

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 21 December 2000;

- **Draft Pinetec Woodlot Project 2001 Prospectus, prepared and issued by Pinetec Limited ('Pinetec'), dated 16 February 2001;**
- **Draft Constitution for Pinetec Woodlot Project 2001 between NKH Securities ('NKH') and the Grower, dated 2 February 2001;**
- **Draft Lease and Management Agreement for Pinetec Woodlot Project 2001 ('the agreement') between NKH and Pinetec Properties Pty Ltd ('the Lessor') and the Grower, dated 2 February 2001;**
- Draft Compliance Plan for Pinetec Woodlot Project 2001 adopted by NKH as 'the Responsible Entity', dated 2 February 2001;
- Project Management Agreement between NKH and Pinetec Plantations Pty Ltd ('the Manager') and Pinetec ('the Guarantor'), dated 18 December 2000;
- Option Agreement between Pinetec Properties Pty Ltd and the current owners of the Land, not dated;
- Option Agreement between Pinetec Properties Pty Ltd and the current owners of the Land, not dated;
- Independent Forester's Report, dated 2 February 2001;
- Offtake Agreement between NKH and Pinetec Limited, not dated;
- Director's Undertaking provided by NKH, dated 21 February 2001; and
- Additional correspondence received from the applicant, dated 2 February 2001, 8 February 2001, 16 February 2001, 21 February 2001, 26 February 2001 and 27 February 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 that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, 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 a part of the arrangement. The effect of this agreement is summarised as follows.

PR 2001/18**Overview**

17. The arrangement is called the Pinetec Woodlot Project 2001.

Location	The Esperance region of Western Australia. Land located at an average economical haulage distance of no more than 110 km from the Esperance port.
Type of business each participant is carrying on	Long term commercial afforestation business growing a mix of <i>Radiata pine</i> and <i>Tasmanian bluegum</i> for the purpose of producing timber for woodchipping, sawlog and veneer log.
Number of hectares to be under cultivation	This prospectus provides for 2,250 hectares to be planted.
Size of each Woodlot	1 hectare
Number of trees per hectare	1,449 <i>Radiata pines</i> per hectare 1,136 <i>Tasmanian bluegum</i> per hectare
Expected production	480 cubic metres per hectare
Term of the investment	26 years
Initial cost	\$5,489
Initial cost per hectare	\$5,489
Ongoing costs	<p>NKH is to be paid 8% of net proceeds of sale as Management Fees. The Lessor is to be paid 7% of net proceeds of sale as Rent fees. Pruning costs payable are estimated to be:</p> <ul style="list-style-type: none"> • Year 4 - \$339.90; • Year 6 - \$261.80; and • Year 8 - \$346.50. <p>Three years after the end of the initial period Growers will be charged for the cost of insurance for each Woodlot. An annual administration fee of \$40 (indexed) per Grower will be payable to NKH for arranging the insurance. NKH must reimburse the Project Manager for the costs of harvesting, processing and the cost of sales from the gross proceeds of sale. NKH is to be reimbursed for all costs, charges and expenses that are incurred by NKH in the proper performance of its duties in establishing, administering and winding up of the Project.</p>
Other costs	Purchase of 1,400 shares in Pinetec Ltd.

18. The Project is to carry out a large scale planting of *Radiata pine* and *Tasmanian bluegums* upon land which is to be held by the Lessor. The Project is for a period of twenty six years.
19. Growers participating in the arrangement on Project land located in the Esperance region of Western Australia will enter into a Lease and Management Agreement between NKH (as Responsible Entity) and Pinetec Properties (as Lessor) and the Grower. This agreement is set out in the Schedule to the Constitution.
20. The Agreement gives a Grower a lease from Pinetec Properties Pty Ltd over an identifiable area of land called a 'Woodlot' until the Project is terminated pursuant to the provisions of the agreement or, up until the trees are harvested and sold and net income distributed, which ever happens first.
21. The Grower engages NKH to carry out the management of their Woodlot. The NKH will establish and cultivate *Radiata pine* and *Tasmanian bluegum* and be responsible for pruning, harvesting, processing, marketing and selling the timber. Growers may elect, on or before 30 June 2004, to collect their own Collectable Produce by giving written notice to the Responsible Entity and thereby become an Electing Grower (clause 17.1) or the Responsible Entity will sell the forest produce on behalf of the Non-Electing Growers for the maximum practicable price (clause 14 and item 7C of the schedule).
22. Under the Prospectus, Pinetec proposes to offer 2,250 Woodlots of 1 hectare, which will be planted with *Radiata pine* and *Tasmanian bluegum* seedlings following execution of a Lease and Management Agreement. Subject to suitable land being available, further Woodlots will be issued after 30 June 2001 if more than 2,250 Woodlots are subscribed for. The Prospectus states that there is no minimum subscription for this Project. Each investor may subscribe for a minimum of one Woodlot, at a cost of \$5,489 per Woodlot. The Woodlot will consist of two separate land areas. Each Grower will be allotted an area of approximately 0.66 hectares that will be planted with *Radiata pine* and an area of approximately 0.33 hectares that will be planted with *Tasmanian bluegum*. The Responsible Entity will maintain a register of Growers, identifying the Woodlots held by Growers. Approximately 966 *Radiata Pines* and 379 *Tasmanian bluegums* will be planted per Woodlot.
23. The date of a Grower's application determines the date of execution of the Lease and Management Agreement and the period of provision of Plantation Establishment Services to which the Establishment Fee relates.
24. Growers will execute a Power of Attorney enabling the Responsible Entity, NKH, to act on their behalf as required when they make an application for a Woodlot.

25. Each Grower must also subscribe for one thousand four hundred shares in Pinetec Limited.

26. The Lessor has entered into Option Agreements for the Purchase of the Project Land with the current Land Owners. The agreements expire on 31 March 2001. The land will be secured by purchase upon the exercise of the option agreements.

Constitution

27. The relevant Constitution establishes the Project and operates as a deed binding on all of the Growers of the Project and the Responsible Entity. The Constitution sets out the terms and conditions under which NKH agrees to act as Responsible Entity and thereby manage the Project. The Lease and Management Agreement is annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 26 of the Constitution, the Responsible Entity will keep a register of Growers. Growers may assign their interest only in certain circumstances as set out in clause 34 of the Lease and Management Agreement.

Compliance plan

28. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. The Compliance Plan's purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease and Management Agreement

29. The Lease and Management Agreement sets out the roles and obligations of the parties to the agreement. It is entered into between the Responsible Entity and the Grower for each Leased Area. Under the agreement the Lessor grants a Lease to the Grower and the Grower appoints the Responsible Entity to establish, maintain, harvest, process and sell the trees on the Grower's Woodlot.

30. The agreement commences on the date the Grower's Application is accepted by the Responsible Entity. The Project is terminated pursuant to the provisions of the agreement or, upon distribution of net income to Growers following final harvest and sale of the Forest Produce. Therefore, the arrangement will terminate with regards to the areas of the Woodlot upon which *Tasmanian bluegum*

trees are planted following harvest in approximately year 12 after the initial period and with regards to the areas of the Woodlot upon which *Radiata pine* trees are planted following final harvest in approximately year 26 after the initial period.

31. Growers participating in the Project are granted an interest in land by the Lessor in the form of a lease to use their Woodlot for the purpose of conducting a long-term afforestation business.

32. Each Grower must pay Rent to the Lessor being an amount of 7% of net proceeds of sale as specified in clause 4.1 of the Lease and Management Agreement. Payment of Rent is deferred until the year harvest proceeds are received.

33. Under the terms of the Lease and Management Agreement inter alia the Grower :

- must not use or permit any other person to use the area for any purpose other than that of commercial silviculture of *Radiata pine* and *Tasmanian bluegum*;
- install or remove any fixtures, earth, gravels, stones, sand or minerals, or any fittings and improvements from the Leased Area without the consent of the Lessor;
- do anything which would invalidate or increase the premiums of any insurance policies in respect of the Leased Area, Trees or the Fixtures; and
- do or permit to be done on the Leased Area anything that will cause a nuisance, disturbance, obstruction or damage.

34. In return, the Grower has the right to peaceably possess and enjoy the Leased Area during the term of the Agreement. The Trees will be the property of the Grower for the Term of the Agreement.

35. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement. The services to be performed are specified in the definitions of 'Initial Services', 'Ongoing Services' and 'Selling and Marketing Services'. The Responsible Entity will supervise and manage all silvicultural activities to be carried out on the Leased Area on behalf of the Grower including, but not limited to the provision of the following services:

- acquire appropriate seeds and seedlings;
- prepare the ground for planting as necessary;
- plant 1,449 *Radiata pine* seedlings per hectare and 1,136 *Tasmanian bluegum* seedlings per hectare;

- cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the trees;
- keep access roads and firebreaks in good repair and the Woodlot free from rabbits and other vermin;
- replant contiguous areas of more than one hectare with sufficient seedlings or trees to ensure that there are at least 1,232 *Radiata pine* seedlings or trees per hectare and 966 *Tasmanian bluegum* seedlings or trees per hectare;
- carry out or arrange for Pruning, Harvesting and Processing of trees to be carried out;
- maintain the Woodlot according to good silvicultural and forestry practices; and
- supervise and manage the negotiating and making of sales of forest produce.

36. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Fees

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

- **Establishment Fee** of \$5,489 payable on Application for the period from the Commencement Date to 30 June in the financial year in which execution of the Agreement takes place;
- Three years after the end of the initial period Growers will be charged for the **cost of insurance** against destruction or damage of the Leased Area by fire and other usual risks for each Woodlot. Irrespective of how many Woodlots are held by a Grower, an annual administration fee of \$40 (indexed) per Grower will be payable to NKH for arranging the insurance.
- The Responsible Entity will invoice the Grower for the **cost of pruning *Radiata pine*** in years 4, 6 and 8 of the Project:
- The Project Manager will be reimbursed for the **costs of harvesting, processing and the cost of sales** from the Gross Proceeds of Sale.

- The Responsible Entity is entitled to a **Management Fee** of 8% of the net proceeds of sale of each harvest in consideration for carrying out the Ongoing Services, the Harvesting and the Processing throughout the period from completion of the Plantation Establishment Services until harvest;
- At each relevant harvest, the Lessor is entitled to 7% of the net proceeds of sale of each harvest for **Rent** throughout the term of the agreement;
- NKH is to be reimbursed from Project Property for all costs, charges and expenses that are incurred by NKH in the proper performance of its duties in establishing, administering and winding up of the Project (clause 7.2 of the Constitution).

38. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Application Fund. The application moneys will be released by the Responsible Entity when it is reasonably satisfied that certain criteria set out in the Constitution have been met (clauses 14 and 15 of the Constitution).

Plantation Establishment

39. For Growers who are allotted Woodlots on or before 31 May 2001, the Plantation Establishment Services will be undertaken by the Manager prior to 30 June 2001. NKH undertakes to ensure that all Plantation Establishment Services are provided in relation to each Woodlot by 30 June 2001. From 1 June 2001, NKH may accept applications for any Woodlots where it is reasonably apparent that they will be able to complete all of the Plantation Establishment Services in relation to those Woodlots by 30 June 2001. NKH will be monitoring on a daily basis its ability to complete the Plantation Establishment Services by 30 June 2001. Where Plantation Establishment Services have commenced to be provided for Growers who are allotted Woodlots from 1 June 2001 in accordance with the Director's Undertaking, and due to unforeseen circumstances the work is not completed by 30 June 2001, NKH will complete the Plantation Establishment Services by 31 July 2001. NKH will advise each such Grower of the deductions they will be entitled to claim. Where NKH receives Woodlot Applications after 31 May 2001 and considers that the Plantain Establishment Services can not be completed by 30 June 2001 the Plantation Establishment Services will be provided between 1 July 2001 and 30 June 2002. In addition, where applications are processed on or after 1 July 2001 and prior to the closing date of the Prospectus Growers will commence

participation in the Project in the 2001/2002 income year. After the initial period, NKH will maintain the trees in accordance with good silvicultural practice. The services to be provided by NKH over the term of the Project are defined in items 7A, 7B and 7C of the Lease and Management Agreement.

40. The Responsible Entity will not undertake any work on behalf of a Grower on a Leased Area prior to the Grower subscribing for an interest in the Project.

Harvesting

41. At all times the Grower has full right, title and interest in the Forest Produce and the right to have the forest produce sold for their benefit (clause 19.1). Unless the Grower elects to take possession of their timber, the Responsible Entity will arrange the marketing and sale of the forest produce.

42. Harvesting and processing of some of the *Radiata pine* is to be carried out at approximately 10 years and 18 years after the initial period. The balance of the *Radiata pine* will be harvested at approximately 26 years after the end of the initial period. The Responsible Entity will harvest and process the *Tasmanian bluegum* trees approximately 12 years after the initial period (clause 16.1 of the Lease and Management Agreement).

43. Growers will share in the Gross Proceeds of Sale on a proportionate basis following the payment of the Management Fee, Rent Fee and any other amounts due and payable by the relevant Grower (clause 21).

44. NKH will ensure that the Gross Proceeds of Sale of the Project are paid into the Proceeds Fund trust account. The Growers' Proportional Share of the costs incidental to the Harvesting, Processing and sale of the produce will be paid from the Gross Proceeds of Sale to the Project Manager. From the net proceeds of sale NKH will receive an amount equal to 8% of the relevant Grower's Proportional Share of the Management Fee and any other amounts payable by the Grower under the terms of the Lease and Management Agreement and the Constitution as remuneration for the services provided following completion of the establishment services. The Lessor will receive 7% of the relevant Grower's Proportional Share of the Rent. The balance of the Net Proceeds of Sale will be distributed to the Non-Electing Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Proportional Share' are defined in clause 1 of the Lease and Management Agreement.

45. If a Grower is an 'Electing Grower' (clauses 1 and 17 of the Lease and Management Agreement), the Grower's Proportional Share of the costs of Pruning, Harvesting, Processing, Rent owed to the

Lessor and the Responsible Entity's remuneration, are due for payment at the time of collection specified by the Responsible Entity for collection of the Electing Grower's Collectable Produce (clause 17.2 and 17.3 of the Lease and Management Agreement).

Finance

46. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

47. 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; 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, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable income

48. A Grower's share of the gross sale proceeds derived from the sale of timber harvested from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5 of the

ITAA 1997. Section 17-5 of the ITAA 1997 excludes amounts relating to GST payable on taxable supplies from assessable income.

Section 8-1

Deductions where a Grower is not registered nor required to be registered for GST whose Plantation Establishment Services are completed by 30 June 2001

49. A Grower may claim the deductions in the following table where the Grower:

- participates in the Project on or before 31 May 2001 to carry on the business of afforestation; or
- participates in the Project after 31 May 2001 to carry on the business of afforestation; and
- has an application for Woodlots accepted in accordance with the Director's Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and the Growers Plantation Establishment Services are completed by 30 June 2001;

and

- incurs the fees shown in paragraph 37; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	30/6/2001	30/6/2002	30/6/2003
Establishment Fees	8-1	\$5,489 See note (i) below		
Interest	8-1	As incurred See note (ii) below	As incurred See note (ii) below	As incurred See note (ii) below

Notes:

- (i) Where a Grower incurs the Establishment Fees as required by the Lease and Management Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things that will not 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 95 to 102 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 that the Growers enter to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 106 to 108 below as those rules may be applicable if interest is prepaid.

Deductions where a Grower is not registered nor required to be registered for GST, invests in the project after 31 May 2001 and due to unforeseen circumstances Plantation Establishment Services have not been completed by 30 June 2001

50. A Grower may claim the deductions using the methods and tables in paragraph 52 and 53 where the grower:

- participates in the Project after 31 May 2001 to carry on the business of afforestation;
- has an application for Woodlots accepted in accordance with the Director’s Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and has had Plantation Establishment Services provided by NKH but due to unforeseen circumstances the services are not completed by 30 June 2001 the services will be provided by 31 July 2001;
- incurs the fees shown in paragraph 37; and
- is not registered nor required to be registered for GST.

Section 8-1 – Prepaid fees

51. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 **cannot** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is ‘excluded expenditure’ (see note (ii) below).

52. The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the ‘eligible

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service period' means, generally, the period over which the services are to be provided.

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

53. In this Project, the tax deductions allowable for the Establishment Fees (detailed at paragraph 37 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 114 and 115.

Fee Type	ITAA 1997 Section	30/6/2001	30/6/2002	30/6/2003
Establishment Fees	Section 8 -1	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below	
Interest	Section 8 -1	see notes (ii) (iii) & (iv) below	see notes (ii) (iii) & (iv) below	see notes (ii) (iii) & (iv) below

Notes:

- (i) The Establishment fees shown at paragraph 37 above are **NOT deductible in full** in the year incurred. The deduction for each year's fees must be determined using the formula above (see paragraph 52). The NKH will inform Growers of the number of days in the eligible service period in the first expenditure year. In addition, NKH will inform Growers of the total number of days of the eligible service period. These figures are necessary to calculate the deduction allowable for the fees incurred. See Example 2 at paragraph 114.
- (ii) Amounts of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 115). Deductibility of amounts of \$1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as the prepaid Establishment Fee, i.e., using the formula shown above (in paragraph 52).
- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project

should read carefully the discussion of the prepayment rules in paragraphs 95 to 108 below as those rules may be applicable if interest is prepaid.

- (iv) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 98 to 102). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

Deductions where a Grower is not registered nor required to be registered for GST, invests in the project after 31 May 2001 and the Responsible Entity considers that Plantation Establishment Services can not be completed by 30 June 2001

54. A Grower may claim the deductions using the methods and tables in paragraph 56 and 57 where the grower:

- participates in the Project after 31 May 2001 to carry on the business of afforestation;
- has an application for Woodlots accepted in accordance with the Director's Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and the Responsible Entity considers that the Plantation Establishment Services **can not** be completed by 30 June 2001;
- incurs the fees shown in paragraph 37; and
- is not registered nor required to be registered for GST.

Section 8-1 – Prepaid fees

55. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 **can not** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is 'excluded expenditure' (see note (ii) below).

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56. The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the 'eligible service period' means, generally, the period over which the services are to be provided.

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

57. In this Project, the tax deductions allowable for the Establishment Fees (detailed at paragraph 37 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 114 and 115.

Fee Type	ITAA 1997 Section	30/6/2001	30/6/2002	30/6/2003
Establishment Fees	Section 8 -1	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below	
Interest	Section 8 -1	see notes (ii) (iii) & (iv) below	see notes (ii) (iii) & (iv) below	see notes (ii) (iii) & (iv) below

Notes:

- (i) The Establishment fees shown at paragraph 37 above are **NOT deductible in the year incurred**. The deduction for each year's fees must be determined using the formula above (see paragraph 56). The NKH will inform Growers of the number of days in the eligible service period in the first expenditure year. These figures are necessary to calculate the deduction allowable for the fees incurred. See Example 2 at paragraph 114.
- (ii) Amounts of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 115). Deductibility of amounts of \$1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as the prepaid Establishment Fee, i.e., using the formula shown above (in paragraph 56).
- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this

Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 95 to 108 below as those rules may be applicable if interest is prepaid.

- (iv) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 98 to 102). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

Deductions where a Grower is not registered nor required to be registered for GST and invests in the Project on or after 1 July 2001

58. A Grower may claim the deductions in the following table where the Grower:

- participates in the Project on or after 1 July 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 37; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	30/6/2001	30/6/2002	30/6/2003
Establishment Fees	8-1		\$5,489	
Interest	8-1		As incurred See note (i) below	As incurred See note (i) below

Notes:

- (i) Where a Grower incurs the Establishment Fees as required by the Lease and Management Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things that will not 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 95 to 102 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 that the Growers enter to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 95 to 108 below as those rules may be applicable if interest is prepaid.

Deductions where a Grower is registered or required to be registered for GST whose Plantation Establishment Services are completed by 30 June 2001

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

- participates in the Project on or by 31 May 2001 to carry on the business of afforestation; or
- participates in the Project after 31 May 2001 to carry on the business of afforestation; and
- has an application for Woodlots accepted in accordance with the Director's Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and the Growers Plantation Establishment Services are completed by 30 June 2001.

and

- incurs the fees shown in paragraph 37; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables at paragraph 49 above will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 113.

Deductions where a Grower is registered or required to be registered for GST invests in the project after 31 May 2001 and due to unforeseen circumstances initial services have not been completed by 30 June 2001

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

- participates in the Project after 31 May 2001 to carry on the business of afforestation;
- has an application for Woodlots accepted in accordance with the Director's Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and has had Plantation Establishment Services provided by NKH but due to unforeseen circumstances the services are not completed by 30 June 2001 the services will be provided by 31 July 2001;
- incurs the fees shown in paragraph 37; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables at paragraph 53 above will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 113.

Deductions where a Grower is registered or required to be registered for GST, invests in the project after 31 May 2001 and Responsible Entity considers that Plantation Establishment Services can not be completed by 30 June 2001

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

- participates in the Project after 31 May 2001 to carry on the business of afforestation;
- has an application for Woodlots accepted in accordance with the Director's Undertaking provided on behalf of NKH (refer to paragraphs 15 and 39) and the Responsible Entity considers that the Plantation Establishment Services **can not** be completed by 30 June 2001;
- incurs the fees shown in paragraph 37; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables at paragraph 57 above will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 113.

Deductions where a Grower is registered or required to be registered for GST who invests in the Project on or after 1 July 2001

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

- participates in the Project on or after 1 July 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 37; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables at paragraph 58 above will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 113.

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

Section 35-55 – Commissioner’s discretion

63. For a Grower who is an individual and who enters the Project during the years ended 30 June 2001 or 30 June 2002, 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 2010 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

64. 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 82 in the Explanations part of this Ruling, below).

65. 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.

66. 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)(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.

Section 82KL

67. Section 82KL does not apply to deny the deduction otherwise allowable.

Part IVA

68. 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

Section 8-1

69. 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 that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

70. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the timber's sale from the scheme will constitute 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.

71. Generally, an investor will be carrying on a business of afforestation where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the timber;
- the afforestation activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

72. For this Project, Growers have rights under the Lease and Management Agreement 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 same agreement Growers appoint the Responsible Entity to provide services such as planting, cultivating, tending, fertilising, replanting, spraying and otherwise caring for the trees as and when required according to good silvicultural practice. Growers are considered to control their investment. The specific cost of these services provided in the initial period will total \$5,489.

73. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and a legal interest in leased land. Growers have the right to personally market and sell the timber attributed to their Woodlot or they may appoint the Responsible Entity to arrange the marketing and sale of the timber for them. Growers will have a continuing interest in the trees.

74. Growers have the right to use the land in question for afforestation purposes and to have the Responsible Entity come onto the land to carry out its obligations under the Constitution and the Lease and Management Agreement. The Growers' degree of control over the Responsible Entity, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Responsible Entity's activities. Growers are able to terminate

arrangements with the Responsible Entity in certain instances, such as cases of default or neglect. The afforestation activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

75. 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 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.

76. Growers will engage the professional services of a Responsible Entity 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.

77. 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.

78. The fees associated with the afforestation activities will relate to the gaining of income from the business and, hence, have a sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will, therefore, be deductible under paragraph 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component of the management fee is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

79. 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

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- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

80. 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.

81. 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.

82. 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 Projects, they are beyond the scope of this Product Ruling and are not considered further.

83. 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).

84. 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 Woodlot during the years ended 30 June 2001 or 30 June 2002 is unlikely to pass one of the objective tests until the year ended 30 June 2011.

85. 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.

86. 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 2010.

87. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised 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.

88. 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 63) in the manner described in the Arrangement (see paragraphs 15 to 47), 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.

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

- the report of the Independent Forester and additional evidence provided with the application by the Responsible Entity; and
- independent, objective and generally available information relating to the plantation timber industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Sections 82KZME and 82KZMF - prepaid fees

90. Expenditure prepaid by Growers, who:

- invest in the Project after 31 May 2001 and due to unforeseen circumstances Plantation Establishment Services have not been completed by 30 June 2001; or

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- invest in the project after 31 May 2001 and the Responsible Entity considers that Plantation Establishment Services can not be completed by 30 June 2001,

for the Establishment Fee meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

91. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid Establishment Fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and
- have 'eligible service periods' (for each of the fees) that end not more than 13 months after the Member incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The 'eligible service period' (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

92. In relation to an 'agreement' referred to in subsection 82KZME(3), the Project is an 'agreement' where, during the term of this Product Ruling:

- the Grower's allowable deductions attributable to the Project for each expenditure year exceeds the Grower's assessable income from the Project (if any) for the expenditure year; and
- the Grower does not have day-to-day control over the operation of the Project; and
- there is more than one Grower participating in the Project.

93. The prepaid Establishment fees incurred by Growers do not fall within any of the 5 exceptions to section 82KZME and, therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the Establishment fees over the period that the services for which the prepayment is made are performed.

94. Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore,

deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid fee is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Prepayments provisions - sections 82KZM, 82KZMA - 82KZMD and 82KZME - 82KZMF - for those Growers who invest in the Project on or before 31 May 2001, on or after 1 June 2001 and the Responsible Entity considers that it is able to complete the Plantation Establishment Services by 30 June 2001 and on or after 1 July 2001

95. 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.

96. In this Project, the fee for Establishment Services of \$5,489 per Woodlot will be incurred on execution of the Lease and Management Agreement. The fee is charged for providing management services to a Grower by 30 June of the year of execution of the Agreements. In particular, the 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 fee has been inflated to result in reduced fees being payable for subsequent years.

97. 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 Responsible Entity 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 37, 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.

Prepayments where the eligible service period exceeds 13 months

98. Although not required under the Arrangement described in this Product Ruling, 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 96 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.

99. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Rent 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, where the 'eligible service period' exceeds 13 months, whether the Growers is a 'small business taxpayer'.

100. 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:

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

101. 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 103 to 105) 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 100 above, concerning section 82KZMF.

102. 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(7) 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 Rent Fee is \$1,000 or more, then the amount and

timing of the deduction allowable must be determined using the formula shown above.

Small business taxpayers

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

104. 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.

105. '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).

Interest deductibility

106. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier 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.

107. 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. 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 that is not described in the Arrangement or otherwise dealt with in the Product Ruling.

108. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid 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) as shown above at paragraph 100.

Section 82KL

109. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'.

Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

110. 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).

111. The Project will be a ‘scheme’ commencing with the issue of the Prospectus. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 49 to 62 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

112. 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 are 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’

113. 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:

$$\frac{1}{11} \times \$5,500 = \$500$$

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).

Example 2 – prepaid expenditure and the apportionment of fees

114. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

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

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

115. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\begin{array}{r} \$3,600 \times \frac{365}{365} \\ \hline \end{array}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Detailed contents list

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Commissioner of Taxation

7 March 2001

<i>Previous draft:</i>	- ITAA 1997 35-10
Not previously issued in draft form	- ITAA 1997 35-10(2)
	- ITAA 1997 35-10(3)
	- ITAA 1997 35-10(4)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-30
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<i>Subject references:</i>	- ITAA 1997 35-55(1)
- carrying on a business	- ITAA 1997 35-55(1)(a)
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- fee expenses	- ITAA 1997 Subdiv 960-Q
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