



PR 2001/51 - Income tax: ITC Hardwood Timber Project 2001

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



Product Ruling

Income tax: ITC Hardwood Timber Project 2001

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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 this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangements to which this Ruling relates. This Ruling is about arrangements set out in the ITC Hardwood Timber Project 2001 Prospectus and comprises the ITC Pulpwood Project 2001 and the ITC Solidwood Project 2001. These arrangements are sometimes referred to as the 'Pulpwood Project', the 'Solidwood Project', or simply as 'the Project(s)', or the 'product(s)'.

Tax laws

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);
 - Part 2-25 (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 the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Projects are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as these. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into any of the arrangements described below on or after the date of this Ruling. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

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

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 53) 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 26 April 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 any of the specified arrangements during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no 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 February 2001;
- Draft Prospectus to be issued by ITC Project Management Ltd ('ITCPM'), received 1 March 2001;
- Draft **Management Agreement** for the ITC Pulpwood Project 2001 between ITCPM and the Grower, undated, received 1 March 2001;
- Draft Memorandum (Management Agreement Provisions – February 2001) for the ITC Pulpwood Project 2001, undated, received 1 March 2001;
- Draft **Management Agreement** for the ITC Solidwood Project 2001 between ITCPM and the Grower, undated, received 1 March 2001;
- Draft Memorandum (Management Agreement Provisions – February 2001) for the ITC Solidwood Project 2001, undated, received 1 March 2001;
- Draft **Land Agreement** for the ITC Pulpwood Project 2001 between ITCPM and the Grower, undated, received 1 March 2001;
- Draft Memorandum (Land Agreement Provisions – February 2001) for the ITC Pulpwood Project 2001, undated, received 1 March 2001;
- Draft **Land Agreement** for the ITC Solidwood Project 2001 between ITCPM and the Grower, undated, received 1 March 2001;
- Draft Memorandum (Land Agreement Provisions – February 2001) for the ITC Solidwood Project 2001, undated, received 1 March 2001;
- Draft Constitution of the ITC Pulpwood Project 2001, undated, received 1 March 2001;
- Draft Constitution of the ITC Solidwood Project 2001, undated, received 1 March 2001;
- Draft Compliance Plan of the ITC Pulpwood Project 2001, undated, received 1 March 2001;
- Draft Compliance Plan of the ITC Solidwood Project 2001, undated, received 1 March 2001;

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- Additional correspondence from the Applicant dated 4 April 2001 and 5 April 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 arrangements 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 arrangements. The effect of these agreements is summarised as follows.

Overview

17. These arrangements are called the ITC Pulpwood Project 2001 and the ITC Solidwood Project 2001. Growers may participate in either, or both, of the Projects.

	Pulpwood Project	Solidwood Project
Locations	<ul style="list-style-type: none"> • South-west and southern coastal regions of Western Australia; • the Green Triangle region of western Victoria and south-eastern South Australia; and • sub-tropical regions of central Queensland. 	
Type of business each participant is carrying on	Commercial growing and cultivation of: <ul style="list-style-type: none"> • Tasmanian Blue Gum (<i>Eucalyptus globulus</i>); • Flooded Gum (<i>Eucalyptus grandis</i>); and/or • Flooded Gum/River Red Gum hybrid (<i>Eucalyptus grandis x Eucalyptus camaldulensis</i>) and other hybrids for the purpose of harvesting and selling timber.	
Number of hectares available for cultivation	Western Australia – 5,000 hectares Green Triangle – 3,000 hectares Queensland – 2,000 hectares	
Size of each Plantation Unit	Approximately 1 hectare	

	Pulpwood Project	Solidwood Project
Payment Options	<ul style="list-style-type: none"> • Annual Payment method • Deferred Cost method 	<ul style="list-style-type: none"> • Annual Payment method • Prepaid Costs method • Deferred Cost method
Minimum investment	<ul style="list-style-type: none"> • 5 Plantation Units under the Annual Payment method • 3 Plantation Units under the Deferred Cost method 	<ul style="list-style-type: none"> • 5 Plantation Units under the Annual Payment and Prepaid Costs methods • 2 Plantation Units under the Deferred Cost method
Number of trees per hectare	Approximately 800	<ul style="list-style-type: none"> • Approximately 800 prior to thinning of the Plantation at approximately 8 years • Approximately 250 following thinning
Expected production	270 cubic metres of timber per hectare	425 cubic metres of timber per hectare
The term of the investment	10 years	17 years
Initial minimum cost	<ul style="list-style-type: none"> • \$11,000 under the Annual Payment method • \$13,560 under the Deferred Cost method (including \$3,000 for the acquisition of ITC Timberlands Ltd Preference Shares) 	<ul style="list-style-type: none"> • \$11,000 under the Annual Payment method • \$46,310 under the Prepaid Costs method • \$10,800 under the Deferred Cost method (including \$2,000 for the acquisition of ITC Timberlands Ltd Preference Shares)
Initial minimum cost per hectare	As above	As above

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Ongoing and other costs	<ul style="list-style-type: none"> • Land fees plus fees for Planting and Annual Services • Under the Deferred Cost method, these fees are deferred until the harvest proceeds are distributed 	<ul style="list-style-type: none"> • Land fees plus fees for Planting, Pruning and Annual Services • Under the Prepaid Costs method, these fees comprise part of the initial payment • Under the Deferred Cost method, these fees are deferred until the harvest proceeds are distributed
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18. Under this Prospectus, ITCPM proposes to offer 10,000 hectares of land for Eucalypt plantations throughout Western Australia, South Australia, Victoria and Queensland. The Prospectus offers participation in a Pulpwood project for a period of approximately 10 years or a Solidwood Project for a period of approximately 17 years. ITCPM will enter into Head Leases with landowners for the Project land. ITC Timberlands Ltd will own some of the land where the Projects are to be established.

19. There is no minimum subscription for the Project. Growers participating in the arrangement will enter into a Land Agreement with ITCPM, as the Responsible Entity. Pursuant to the Land Agreement, Growers acquire either a leasehold interest or, for land in Queensland, a profit a prendre (Forest Right).

20. Fees for the Project are payable to ITCPM. Growers may elect to participate in the Project under one of several payment methods. Growers participating in the Pulpwood Project may choose to pay an initial fee on Application and annual fees thereafter, the 'Annual Payment' method or an initial fee on Application and defer the balance of the fees until the final harvest, the 'Deferred Cost' (single payment) method. Growers participating in the Solidwood Project may choose either of the above payment methods. Additionally, they may choose to pay fees in advance for the term of the Project, the 'Prepaid Costs' method.

21. The Land Agreement is executed over an identifiable area of land called a 'Plantation Unit' and is effective until the trees are harvested and sold and the net income distributed. Each Plantation Unit will comprise approximately 1 hectare (but may vary from property to property based on the assessed productivity of each property) and will be planted with sufficient trees to provide the

expected timber harvest as set out in the Prospectus and the table above at paragraph 17.

22. Each investor is required to subscribe for a minimum number of Plantation Units, also indicated in the table above. Additionally, Growers electing to pay under the Deferred Cost method are required to subscribe for a minimum of 1,000 preference shares in ITC Timberlands Limited for each Plantation Unit to which they subscribe. The Plantation Units are separately identified on a Plantation Area Map annexed to the Agreement. Growers will receive a Certificate detailing the Plantation Units they have been allocated.

23. For Growers that enter the Project by 31 May 2001, ITCPM undertakes to ensure that Primary Services are completed by 30 June 2001. From 1 June 2001, ITCPM will not accept applications for any Plantation Units where it is apparent that they will not be able to complete all of the Primary Services by 30 June 2001. ITCPM will be monitoring on a daily basis its ability to complete the Primary Services by 30 June 2001. Applications of Growers processed on or after 1 July 2001 and prior to the closing date of the Prospectus will commence participation in the Project in the 2001/2002 income year.

24. The Growers will also enter into a Management Agreement with ITCPM for the management of their Plantation Area. ITCPM will be responsible for establishing and cultivating the trees and harvesting, processing and selling the timber. Timber grown pursuant to the Pulpwood Project is expected to be harvested approximately 10 years after the commencement of the Project. In relation to the Solidwood project, thinning is expected to occur approximately 8 years after the commencement of the Project and a clearfell harvest is anticipated after approximately 17 years.

25. Growers may elect, within 12 months of execution of the Management Agreement, to market and arrange for the sale of their Tree Crop themselves by giving written notice to ITCPM and thereby become a Selling Grower (clause 9.1(a) of the Management Agreement Memoranda). ITCPM will arrange the sale of the Tree Crop on behalf of the Non-Selling Growers.

26. Growers will execute a Power of Attorney enabling ITCPM to act on their behalf as required when they make an application for Plantation Units.

Joint venture

27. The Project will also allow two Growers to enter into a Joint Venture. They will be bound by the Joint Venture Terms set out in the Application Form attached to the Prospectus of the Project. The Joint Venture option is only available under the Annual Payment method.

28. Under this Joint Venture:

- the first Joint Venture Grower will be responsible for procuring the Primary Services; and
- the second Joint Venture Grower will be responsible for procuring the ongoing provision of land, Planting Services, Pruning Services (Solidwood Project only) and Annual Services.

29. With regard to the Pulpwood Project, the Joint Venture Terms provide that each Joint Venture Grower will be entitled to 50% of the Joint Venture Property and, in particular, all saleable wood produced from the Plantation Units. With regard to the Solidwood Project, the Joint Venture Terms provide that this allocation will be 35% to the first Joint Venture Grower and 65% to the second Joint Venture Grower.

Constitution

30. The Constitutions establish the Project and operates as deeds binding on all of the Growers and the Responsible Entity. The Constitutions set out the terms and conditions under which ITCPM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the relevant Constitution by virtue of their participation in the Project. Growers may assign their interest in certain circumstances as set out in clause 11 of the relevant Management Agreement Memoranda.

31. The Responsible Entity will:

- prepare the Management Agreement and the Land Agreement (clause 6);
- ensure that Application Moneys are not released until the appropriate agreements are in place (clause 8);
- keep a register of Growers (clause 27); and
- distribute profits (clause 30).

Compliance Plan

32. As required by the Corporations Law, Compliance Plans have been prepared by ITCPM for the Pulpwood Project and the Solidwood Project. The purpose of the Compliance Plans is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the relevant Constitution and that the interests of Growers are protected.

Interest in Land

33. Growers participating in the Project are granted an interest in land by ITCPM in the form of a sub-lease or right to use their Plantation Area for the purpose of conducting their afforestation business. The sub-lease or right will be granted through a Land Agreement between Growers and ITCPM in accordance with the provisions set out in the agreement (clause 2). Growers may assign their interest in certain circumstances (clause 13).

34. Some of the conditions of the Land Agreement are that the Grower will:

- not use the Plantation Units for a purpose other than growing and harvesting trees;
- comply with sound silvicultural and environment practices adopted within the forestry industry; and
- comply with all laws and regulations relating to the use and occupancy of the Grower's Plantation Units.

Management Agreement

35. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the Agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultant and other specialist services as may be reasonably necessary. The services which ITCPM must perform are specified in Schedule 2 and include:

- procure sufficient Trees to the recommended specifications;
- plant the Trees and maintain adequate stocking of the plantation in accordance with the Management Plan by replacing any contiguous area of dead or missing trees;
- maintain the planting mounds by appropriate cultivation and weed control;
- maintain access roads and fire breaks and use all reasonable measures to keep the Plantation Area free from vermin; and
- report on the growth of the trees every six months.

Fees

36. Fees are payable to ITCPM by the Grower in respect of each Plantation Unit. Growers participating in either Project may elect to

pay fees under the payment methods described at paragraph 20. Joint Venture Growers will pay only the relevant fees as described in paragraph 28.

Annual payment method - Solidwood and Pulpwood Projects

37. The following amounts are payable for both the Solidwood Project and the Pulpwood Project in accordance with Items 1 to 5 of Schedule 3 to the relevant Management Agreement Memorandum and Items 1 & 2 of Schedule 2 to the relevant Land Agreement Memorandum:

- Primary Services fee of \$2,200 payable on or before the date of execution of the Management Agreement;
- Planting Services fee of \$165 payable on 30 November 2001 or on execution of the Management Agreement, whichever is the later;
- Annual Services fee of \$66 payable on 30 November 2001 or execution of the Management Agreement, whichever is the later;
- Thereafter, the Annual Services fee will be payable on 30 November of each year during the term of the Management Agreement, indexed at the annual rate of inflation;
- Land fees of \$275 payable on 30 November 2001 or execution of the Land Agreement, whichever is the later;
- Thereafter, the Land fees will be payable on 30 November of each year during the term of the Land Agreement, indexed at the annual rate of inflation;
- Under the Solidwood Project only, a Pruning Services fee will be payable on 30 November 2004. The amount of the fee will be \$1,100 varied by a percentage equal to the percentage by which the CPI published in respect of the September 2004 quarter has varied against that published in the March 2001 quarter.

Prepaid costs method - Solidwood Project

38. For the Solidwood Project only, the following amounts are payable in accordance with Item 6 of Schedule 3 to the Management Agreement Memorandum and Schedule 2 to the Land Agreement Memorandum:

- Primary Services fee of \$2,200 payable on or before the date of execution of the Management Agreement;
- Planting Services fee of \$165 payable on or before execution of the Management Agreement;
- Pruning Services fee of \$1,100 payable on or before execution of the Management Agreement;
- Total fees for Annual Services of \$1,122 payable on or before execution of the Management Agreement.
- Total Land Fees of \$4,675 payable on or before execution of the Land Agreement.

39. If the final harvest of the Plantation Area occurs after 30 June 2018, Growers will be required to pay additional fees for Annual Services and Land Fees in accordance with Item 4 of Schedule 3 to the Management Agreement Memorandum and Schedule 2 to the Land Agreement Memorandum respectively, from 1 July 2018 to the date of the final harvest.

40. If the final harvest of the Plantation Area occurs before 30 June 2018, ITCPM will refund to the Grower Annual Services fees of \$66 per Plantation Unit and Land Fees of \$275 per Plantation Unit for each whole year between the date of final harvest and 30 June 2018.

Deferred cost method - Solidwood Project

41. The following amounts are payable for the Solidwood Project only in accordance with Schedule 3 to the Management Agreement Memorandum and Schedule 2 to the Land Agreement Memorandum:

- Primary Services fee of \$4,400 payable on or before the date of execution of the Management Agreement;
- Planting Services fee equal to 1.65% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree Crop is delivered to the address nominated by a Selling Grower;
- Annual Services fee equal to 6.6% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree Crop is delivered to the address nominated by a Selling Grower;
- Land Fees equal to 24.75% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree

Crop is delivered to the address nominated by a Selling Grower;

- A Pruning Services fee will be payable at the time of the first thinning of the Tree Crop, approximately 8 years after the Commencement Date. The amount of the fee will be \$1,100 varied by a percentage equal to the percentage by which the CPI published in respect of the quarter ending prior to the payment of the fee has varied against that published in the March 2001 quarter.

Deferred cost method - Pulpwood Project

42. The following amounts are payable for the Pulpwood Project only in accordance with Schedule 3 to the Management Agreement Memorandum and Schedule 2 to the Land Agreement Memorandum:

- Primary Services fee of \$3,520 payable on or before the date of execution of the Management Agreement;
- Planting Services fee equal to 1.65% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree Crop is delivered to the address nominated by a Selling Grower;
- Annual Services fee equal to 6.6% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree Crop is delivered to the address nominated by a Selling Grower;
- Land Fees equal to 24.75% of the Harvest Proceeds is payable at the time that the Harvest Proceeds are distributed to the Grower by ITCPM, or when the Tree Crop is delivered to the address nominated by a Selling Grower.

43. Growers choosing the Deferred Cost option for the payment of fees in either Project must also subscribe for shares in the landowning company, ITC Timberlands Ltd. Applications must be made for 1,000 shares per Plantation Unit at \$1 each. The shares will be a preferred class of shares referred to as 'Project 2001 Class Shares' that carry a cumulative fully franked dividend of 5.5% and will convert to ordinary shares on 30 June 2011, unless investors choose to convert earlier. Growers electing to pay fees under the Annual Payment or Prepaid Costs methods are not obliged but are entitled to also subscribe for shares.

44. ITCPM is also entitled to the following amounts that will be deducted from the Harvest Proceeds:

- the Grower's proportional share of the costs of harvesting; and
- a Harvesting and Marketing Fee equal to 5.5% of the Harvest Proceeds.

45. The Draft Prospectus states at page 21 that ITCPM will insure the Plantations against fire and windstorm at its cost until 30 September in the year of planting. Thereafter, ITCPM will arrange insurance of the Plantation Area on behalf of the Grower to cover against fire and windstorm if so requested. Any insurance premium will be payable by the Grower and ITCPM will charge a fee equal to 10% of the premium paid by the Grower to arrange the insurance.

46. Under the terms of the Constitutions, all moneys received from applications shall be paid to ITCPM as the Responsible Entity, which shall deposit those moneys into an Application Fund in the name of ITCPM. The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitutions have been met (clauses 7, 8 and 9 of the Constitutions).

Planting

47. During the period from the Commencement Date until 30 June 2002, ITCPM will be responsible for planting trees on the Plantation Units. After planting ITCPM will maintain the trees in accordance with good silvicultural practice. The Plantation Area will be replanted to maintain adequate stocking of the Plantation in accordance with the Management Plan by replacing any contiguous area of dead or missing trees. The services to be provided by ITCPM over the term of the Project are outlined in Schedule 2 of the relevant Management Agreement Memorandum.

Harvesting

48. The Grower may, within 12 months of the execution of their agreement, elect itself to market and arrange for the sale of the Tree Crop (clause 9.1 of the relevant Management Agreement Memorandum) or ITCPM will use reasonable endeavours to sell the Tree Crop on the Grower's behalf (Item 5(d) of Schedule 2 to the relevant Management Agreement Memorandum).

49. For the Solidwood Project, harvesting of the trees is expected to take place at age 8 and 17, but is at the discretion of ITCPM. For the Pulpwood Project, a single harvest of all trees is expected to take place after 10 years. All Growers must pay the reasonable costs

incurred by ITCPM in relation to the carrying out of the Harvesting. ITCPM will be entitled to 5.5% of the Harvest Proceeds as a fee payable for Harvesting and Marketing Services.

50. The proceeds from the sale of timber of Non-Selling Growers will be paid direct to ITCPM who must deposit them into a Proceeds Fund (clause 3.3(c) of the Constitutions). Each Grower will have a share in the Proceeds Fund which will be distributed among the Non-Selling Growers according to their Proportional Interest. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1 of the Constitutions.

51. If a Grower is a 'Selling Grower' (clauses 1 and 9 of the Management Agreements), ITCPM will deliver the Grower's proportional share of the forest produce to an address nominated by the Grower. Prior to delivery the Grower must pay to ITCPM the costs of harvesting and delivery of the forest produce and any rent or fees owing to ITCPM (clause 9.1(c) of the Management Agreements).

Finance

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

53. 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' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate;

- 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 ITC Finance Pty Ltd, are involved, or become involved, in the provision of finance for the Project.

Ruling

Section 6-5 - assessable income

54. Gross sale proceeds derived from the sale of timber harvested from the Project, less any GST payable on these proceeds, will be assessable income of the Growers 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.

55. A Joint Venture Grower's share of the gross sale proceeds derived from the sale of timber harvested from the Project, less any GST payable on those proceeds, will be assessable income under section 6-5 of ITAA 1997. The term 'joint venture' is used in this Product Ruling in a general accounting and legal sense, and **not** as a reference to entities that are entitled to apply to the Commissioner to be treated as an approved GST joint venture within the meaning of Division 51 of *A New Tax System (Goods and Services Tax) Act 1999*.

56. Once harvested, a Grower's timber will be trading stock of the Grower. As a consequence, if timber is on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of the ITAA 1997. Each Grower will be notified by ITCPM of the respective amounts to be brought to account in respect of their Proportional Interest in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

57. Dividends derived by Growers from Project 2001 Class Shares in ITC Timberlands Ltd will be assessable income under section 6-5 of the ITAA 1997.

Section 8-1

Deductions where Growers are not registered nor required to be registered for GST

58. A Grower may claim the deductions in one of the following tables according to which fee option the Grower elects for the payment of fees where the Grower:

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- participates in the Project to carry on the business of afforestation;
- incurs the fees shown in the table below; and
- is not registered, nor required to be registered for GST.

Annual payment method - Solidwood and Pulpwood Projects***2001 Growers***

59. Where a Grower (who is not a Joint Venture Grower) elects to pay fees under the Annual Payment method and executes the relevant Land Agreement and Management Agreement by 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - per Plantation Unit	8-1	\$2,200		
Planting Services - per Plantation Unit			\$165 See note (i) below	
Annual Services - per Plantation Unit	8-1		\$66 See note (i) below	See notes (i) & (ii) below
Land Fees - per Plantation Unit	8-1		\$275 See note (i) below	See notes (i) & (ii) below
Interest	8-1	See note (iii) below	See note (iii) below	See note (iii) below
Insurance	8-1	See note (iv) below	See note (iv) below	See note (iv) below

Notes:

- (i) Where a Grower incurs the Land Fees and Management Fees as required by the relevant Land Agreement and Management Agreement respectively, those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done within 13 months of the fees being 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 paragraph 98 unless the expenditure is 'excluded expenditure'.

'Excluded expenditure', being expenditure of less than \$1,000, is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred.

- (ii) Land Fees and Annual Service fees are subject to indexation after the initial period. The amounts will be the prior year fee indexed at the annual rate of inflation.
- (iii) For a Grower using the finance option offered by ITC Finance Pty Ltd interest is deductible in full in the year in which it is incurred. The deductibility or otherwise of interest arising from agreements that Growers enter into with financiers other than ITC Finance Pty Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with ITC Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 97 to 106 below as those rules may be applicable if interest is prepaid.
- (iv) For Growers electing to insure their Plantation Units, premiums paid for insurance of the Plantation Units will be an allowable deduction, subject to the operation of the prepayment provisions discussed at paragraphs 97 to 106 below. Where insurance cover is coordinated by ITCPM, the fee payable to ITCPM will be deductible in full in the year in which it is incurred.

2002 Growers

60. Where a Grower (who is not a Joint Venture Grower) elects to pay fees under the Annual Payment method and executes the relevant Land Agreement and Management Agreement after 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - per Plantation Unit	8-1	\$2,200		
Planting Services - per Plantation Unit		\$165		

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Annual Services - per Plantation Unit	8-1	\$66	See notes (i) & (ii) above	See notes (i) & (ii) above
Land Fees - per Plantation Unit	8-1	\$275	See notes (i) & (ii) above	See notes (i) & (ii) above
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

Joint Venture Growers

61. A Joint Venture Grower may claim the following tax deductions where the Joint Venture Grower:

- participates in either the Solidwood Project or the Pulpwood Project by 30 June 2001 to carry on the business of afforestation;
- incurs the relevant fees shown in paragraphs 37 or 38; and
- is not registered nor required to be registered for GST:
 - (i) for the first Joint Venture Grower, fees in relation to Primary Services and interest (if applicable) as per the Tables at paragraphs 59 and 60 above; and
 - (ii) for the second Joint Venture Grower, fees in relation to Planting Services, Annual Services, Land Fees, interest (if applicable) and insurance as per the Tables at paragraphs 59 and 60 above.

Deferred cost method - Solidwood Project*2001 Growers*

62. Where a Grower elects to pay fees for the Solidwood Project under the Deferred Cost payment method and executes the Land Agreement and Management Agreement by 30 June 2001, the following deductions will be available:

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Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - per Plantation Unit	8-1	\$4,400		
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

2002 Growers

63. Where a Grower elects to pay fees for the Solidwood Project under the Deferred Cost payment method and executes the Land Agreement and Management Agreement after 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - per Plantation Unit	8-1	\$4,400		
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

*Deferred cost method - Pulpwood Project**2001 Growers*

64. Where a Grower elects to pay fees for the Pulpwood Project under the Deferred Cost payment method and executes the Land Agreement and Management Agreement by 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - per Plantation Unit	8-1	\$3,520		
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above

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Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above
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2002 Growers

65. Where a Grower elects to pay fees for the Pulpwood Project under the Deferred Cost payment method and executes the Land Agreement and Management Agreement after 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - per Plantation Unit	8-1	\$3,520		
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

*Prepaid costs method - Solidwood Project**2001 Growers*

66. Where a Grower elects on Application to prepay fees for a period of 17 years in respect of the Solidwood Project, and executes the Land Agreement and Management Agreement by 30 June 2001, the following deductions will be available:

Fee Type	ITAA 1997 Section	Initial Period 30/6/2001	Year 1 30/6/2002	Year 2 30/6/2003
Primary Services - per Plantation Unit	8-1	\$2,200		
Planting Services - per Plantation Unit		See note (v) below	See note (v) below	
Pruning Services - per Plantation Unit		See note (vi) below	See note (vi) below	See note (vi) below
Annual Services - per Plantation Unit	8-1		\$112 See note (vii) below	\$112 See note (vii) below

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Land Fees - per Plantation Unit	8-1		\$467 See note (vii) below	\$467 See note (vii) below
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

Notes:

- (v) Where a Grower invests in six or fewer Plantation Units and prepays fees for Planting Services during the year ended 30 June 2001, the amount will be deductible in full as 'Excluded expenditure', being expenditure of less than \$1,000, and an 'exception' to the prepayment rules. Where a Grower invests in seven or more Plantation Units, the tax deduction for the prepaid Planting Services fee **MUST** be determined using the formula shown in paragraph 98.
- (vi) The prepaid Pruning Services fee of \$1,100 will be deductible over the period in which they are to be performed, being the period from the Commencement Date to 30 June 2005. The tax deduction **MUST** be determined using the formula shown in paragraph 98.
- (vii) Where fees are prepaid beyond 13 months the amount and timing of the tax deductions is determined under subsection 82KZM(1) for 'small business taxpayers' or subsection 82KZMD(2) for taxpayers who are not 'small business taxpayers'. These subsections effectively use the same formula to apportion expenditure over the eligible service period or ten years whichever is the lesser (see paragraphs 101 to 102).

2002 Growers

67. Where a Grower elects on Application to prepay fees for a period of 17 years in respect of the Solidwood Project, and executes the Land Agreement and Management Agreement after 30 June 2001, the following deductions will be available:

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Fee Type	ITAA 1997 Section	Initial Period 30/6/2002	Year 1 30/6/2003	Year 2 30/6/2004
Primary Services - per Plantation Unit	8-1	\$2,200		
Planting Services - per Plantation Unit		\$165		
Pruning Services - per Plantation Unit		See note (vi) above	See note (vi) above	See note (vi) above
Annual Services - per Plantation Unit	8-1	\$112 See note (vii) above	\$112 See note (vii) above	\$112 See note (vii) above
Land Fees - per Plantation Unit	8-1	\$467 See note (vii) above	\$467 See note (vii) above	\$467 See note (vii) above
Interest	8-1	See note (iii) above	See note (iii) above	See note (iii) above
Insurance	8-1	See note (iv) above	See note (iv) above	See note (iv) above

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

68. Where a Grower who is registered, or required to be registered for GST, participates in the Project and is entitled to an input tax credit, then the deductions will exclude any amounts of input tax credit (Division 27 ITAA 1997). See Example 1 at paragraph 119.

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

69. For a Grower who invests in the Project and incurs expenditure as required by the Land and Management Agreements the following provisions of the ITAA 1936 have applications as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM except where the Grower has elected to prepay fees as shown in paragraphs 66 and 67 above (but also see paragraphs 103 to 106);

- expenditure by the Grower does not fall within the scope of sections 82KZMB - 82KZMD except where the Grower has elected to prepay fees as shown in paragraphs 66 and 67 above (but also see paragraphs 103 to 106);
- expenditure by the Grower does not fall within the scope of sections 82KZME - 82KZMF above (but see paragraphs 103 to 106)
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Division 35 - deferral of losses from non-commercial business activities**Section 35-55 – Commissioner's discretion*****Solidwood Project***

70. For a Grower who is an individual and who enters the Solidwood Project during the year ended 30 June 2001, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2008 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. Similarly for a Grower who enters the Solidwood Project during the year ended 30 June 2002, the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2009 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

Pulpwood Project

71. For a Grower who is an individual and who enters the Pulpwood Project during the year ended 30 June 2001, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 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. Similarly for a Grower who enters the Pulpwood Project during the year ended 30 June 2002, the

Commissioner will decide for the income years ending 30 June 2002 to 30 June 2011 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.

72. 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 88 in the Explanations part of this Ruling, below).

73. 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.

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

Explanations

Section 8-1

75. 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?

76. 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.

77. 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.

78. For this Project Growers have, under the Land Agreement, rights over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Management Agreement, Growers appoint the Responsible Entity to provide services such as planting, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the trees as and when required according to good silvicultural practice. Growers are considered to have control of their operations.

79. The Land 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 Plantation Area or they may appoint ITCPM to arrange the marketing and sale of the timber for them. Growers will have a continuing interest in the trees.

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

81. 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.

82. Through ITCPM, Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

83. 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.

84. The fees associated with the afforestation activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will, therefore, be deductible under paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under section 8-1 are met. The exclusions do not apply. Section 8-1 is however, subject to Division 27 of the ITAA 1997.

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

85. 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.

86. 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.

87. 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.

88. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

89. 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).

Solidwood Project

90. A Grower who participates in the Solidwood 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 acquiring the minimum investment in the Solidwood Project in the year ended 30 June 2001, is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2009. Similarly, a Grower acquiring the minimum investment in the Solidwood Project in the year ended 30 June 2002, is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2010.

Pulpwood Project

91. A Grower who participates in the Pulpwood 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 acquiring the minimum investment in the Pulpwood Project in the year ended 30 June 2001, is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2011. Similarly, a Grower acquiring the minimum investment in the Pulpwood Project in the year ended 30 June 2002, is unlikely to pass one of the objective tests, or produce a taxation profit, until the year ended 30 June 2012.

92. 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.

93. 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 interests in the Project in the year ended 30 June 2001, 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 2008 for the Solidwood Project, and until the year ended 30 June 2010 for the Pulpwood Project. For an individual Grower who acquires interests in the Project in the year ended 30 June 2002, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) until the year ended 30 June

2009 for the Solidwood Project, and until the year ended 30 June 2011 for the Pulpwood Project.

94. 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.

95. 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 93) in the manner described in the Arrangement (see paragraphs 15 to 53), 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.

96. 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.

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

97. 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.

98. The amount and timing of tax deductions for any prepaid management fees or prepaid Land 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 or 10 years, whichever is the lesser. 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 Grower is a 'small business taxpayer'. However, each prepayment provision uses the same, or effectively the same formula as that shown below concerning section 82KZMF.

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

Primary Services

99. For Growers that enter this Project during the year ended 30 June 2001, the fees for Primary Services will be incurred on execution of the Management Agreement. The fees are charged for providing management services to a Grower by 30 June of the year of execution of the Agreement. In particular, the Primary Services 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 Primary Services fee has been inflated to result in reduced fees being payable for subsequent years.

100. 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 Primary Services fee is for ITCPM 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 and as set out in paragraphs 37, 38, 41 and 42 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.

Prepaid costs method - Solidwood Project

101. Growers may elect to prepay Land Fees and management fees on application for the remaining life of the Project. As the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure, for a Grower who is a 'small business taxpayer' subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a 'small business

taxpayer' subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

102. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 98 above. However, the 'eligible service period' as defined in subsection 82KZL(1) is restricted to a maximum of 10 years after the day of the expenditure.

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

103. Although not required under either the Management Agreement or the Land Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs 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.

104. 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 above at paragraph 98.

105. 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 either section 82KZM or section 82KZMD will apply in the manner described at paragraphs 101 and 102 above.

106. 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 the minimum of Plantation Units in the Project and the quantum of a prepaid Land Fee or management 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

107. 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.

108. '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).

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

Interest deductibility***(i) Growers who use ITC Finance Pty Ltd as the finance provider***

110. Some Growers may finance their participation in the Project through a loan facility with ITC Finance Pty Ltd. Under the terms of the Loan Agreement to be entered into between those Growers and ITC Finance Pty Ltd, interest must be paid.

111. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of growing trees and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1, subject to the operation of sections 82KZME and 82KZMF.

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

112. The deductibility of interest incurred by Growers who finance their participation in either Project, through a loan facility with a bank or financier other than ITC Finance Pty Ltd, is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

113. 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 for a period that is wholly or partly outside the income year in

which the interest is incurred. Unless such prepaid interest is 'excluded expenditure' any tax deduction that may be allowable will be subject to the relevant prepayments provisions of the ITAA. 'Excluded expenditure' is an amount of expenditure of less than \$1,000.

114. The prepayment provisions are discussed in detail at paragraphs 97 to 106 of this Ruling. However, in broad terms, where interest is prepaid and the period to which the interest relates is wholly or partly outside the income year in which it is incurred, then any tax deduction that is allowable must be determined using the following formula:

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

In the formula, the 'eligible service period' means, generally, the period to which the interest relates.

Section 82KL

115. 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

116. 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).

117. Each of the Projects 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 58 to 67 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.

118. 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.

Example

Example 1 – entitlement to 'input tax credit'

119. 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).

Detailed contents list

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Commissioner of Taxation**26 April 2001**

Previous draft:

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- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 97/16; TD 93/34;
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- ITAA 1936 177D
- ITAA 1936 177D(b)
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Subject references:

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