



PR 2001/52 - Income tax: Plantcorp 2001 Radiata Pine Project

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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: Plantcorp 2001 Radiata Pine Project

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Preamble

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

No guarantee of commercial success

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 Plantcorp 2001 Radiata Pine Project, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997)
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZM (ITAA 1936);
 - Section 82KZMA –82KZMD (ITAA 1936);
 - Section 82KZME –82KZMF (ITAA 1936);
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Business Tax Reform

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

Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

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

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

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

11. 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).

12. 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

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified 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

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

- Application for a Product Ruling, dated 22 December 2000, received 3 January 2001;
- Prospectus for the Plantcorp 2001 Radiata Pine Project prepared for the Responsible Entity, Plantcorp Limited, (Plantcorp) ACN 009 347 406, dated 19 March 2001;

- Supplementary Prospectus for the Plantcorp 2001 Radiata Pine Project prepared for Plantcorp, dated 3 April 2001;
- **Draft copy of Constitution for the Plantcorp 2001 Radiata Pine Property Trust between Plantcorp and each several owner, undated, received on 4 April 2001;**
- Draft copy of Custodian Agreement for the Plantcorp 2001 Radiata Pine Property Trust between Plantcorp and the Custodian, Tower Trust Limited, undated, received 15 March 2001;
- Draft copy of Compliance Plan for the Plantcorp 2001 Radiata Pine Property Trust, undated, received on 4 April 2001;
- **Draft copy of the Constitution for the Plantcorp 2001 Radiata Pine Project between Plantcorp and each Grower, undated, received on 15 March 2001;**
- Draft copy of Custodian Agreement for the Plantcorp 2001 Radiata Pine Project between Plantcorp and the Custodian, Tower Trust Limited, undated, received on 4 April 2001;
- Draft copy of Compliance Plan for the Plantcorp 2001 Radiata Pine Project, undated, received on 3 January 2001;
- **Draft copy of Management Agreement between Plantcorp and each Grower, undated, received on 4 April 2001;**
- **Draft copy of Licence Agreement between the Custodian and each Grower, undated, received on 4 April 2001;**
- Copy of Constitution of Plantcorp, undated, received on 16 February 2001;
- Contract for Sale (November 1) between Plantcorp and the owners to purchase property, dated 14 March 2001;
- Contract for Sale (November 2) between Plantcorp and the owners to purchase property, dated 14 March 2001;
- E-Mail (2) and attachments to ATO from the applicant's representative, dated 16 February 2001;
- E-Mail and attachments to ATO from the applicant's representative, dated 15 March 2001;

- E-Mail and attachments to ATO from the applicant's representative, dated 16 March 2001;
- E-Mail and attachments to ATO from the applicant's representative, dated 4 April 2001;
- E-Mail and attachments to ATO from the applicant's representative, dated 10 April 2001;
- E-Mail and attachments to ATO from the applicant's representative, dated 12 April 2001;
- E-Mail to ATO from the applicant's representative, dated 19 April 2001; and
- E-Mail and attachments to ATO from the applicant's representative, dated 23 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.

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

Overview

16. The arrangement is called the Plantcorp 2001 Radiata Pine Project.

Location	The Project is likely to be located in South Australia and/or Victoria.
Type of business each participant is carrying on	Commercial growing and cultivation of Radiata pine trees for the purpose of harvesting and sale of timber to be used for saw logs, pulp wood and a variety of other timber uses.
Number of hectares under cultivation	1,500 hectares.
Size of each Woodlot	1 hectare.
Number of trees per hectare	1,300
Expected Production	A yield of 640 cubic metres of timber per Woodlot over the life of the project.
The term of the investment	26 years.

Initial fees per Stapled Security (one Unit and one Woodlot)	\$6,683
Second Year Fees per Woodlot	\$440, payable on 1 September 2001.
Ongoing Annual Costs Commencing 1 July 2001	<p>Licence Fee (\$33 per Woodlot indexed annually).</p> <p>Annual woodlot maintenance fee (\$99 per Woodlot indexed annually).</p> <p>A \$209 fee for fertilising and the spraying of foliar zinc, payable on 1 September 2004.</p>
Other costs	<p>Plantcorp is entitled to a Harvest management fee of 10% of Proceeds realised from the sale of wood.</p> <p>To the extent that they are not the responsibility of the purchaser under the Wood Purchase Agreement, the Grower will pay the prescribed portion of costs and expenses of harvesting.</p> <p>Plantcorp is entitled to be paid an amount equal to 50% of the net proceeds from the sale of Carbon Credits.</p> <p>Insurance - If the Grower chooses to insure.</p>
Minimum subscription	200 Woodlots and 200 Units.
Other Features	An interest in Woodlots and Units in the Plantcorp 2001 Radiata Pine Property Trust are a stapled security and cannot be bought or sold independently of each other.

The Project

17. The Plantcorp 2001 Radiata Pine Project will be registered as a Managed Investment Scheme under the Corporations Law.

18. The Prospectus for the project contains a dual offer for Applicants. As Owners, they will own the Project land on which the

Plantation is to be established through a Unit in a Property Trust and as Growers they will own and operate a Radiata Pine Plantation through a Woodlot interest in the Project.

19. A Unit in the Trust will constitute an undivided proportionate beneficial interest in the land. As Trustee of the Property Trust, Plantcorp will purchase the land on which the Plantation is to be established. Plantcorp will appoint a Custodian, Tower Trust Limited, to protect the Owner's legal interest in the land by holding legal title of the land pursuant to the terms of the Custodian Agreement.

20. On acceptance of an Applicant and if the Minimum Subscription is reached, Growers will enter into a Licence Agreement with the Custodian to use approximately one hectare of land (Woodlot) for the purpose of developing, planting, growing, maintaining and harvesting wood from radiata pine.

21. Growers will also enter into a Management Agreement with Plantcorp to have a Radiata Pine Plantation established and maintained for the eventual purpose of felling and sale in twenty six years time.

Interest applied for

22. The Prospectus offer is for a minimum of one Unit in the Property Trust and one Woodlot interest in the Scheme.

23. An interest in a Unit and a Woodlot are a stapled security and cannot be bought or sold independently of each other. Owner units can, however, be owned by an associated entity of a Grower.

24. The Application Price for each Stapled Security is \$6,683 (Subscription Money), and is allocated as follows:

One Unit in the Property Trust	\$2,800
Woodlot preparation and establishment fee	\$3,850
Licence Fee	<u>\$33</u>
Total	\$6,683

25. The Subscription Money will be held by Plantcorp in a Trust Account until minimum subscription is reached.

26. Plantcorp is offering 1,500 Woodlots and 1,500 Units for subscription with the option to accept over-subscriptions (up to 500 Woodlots and 500 Units).

27. No Woodlots or Units will be issued on the basis of this Prospectus later than its expiry date, being 30 June 2001. This ruling will not apply to an application to the Project that has been received or accepted between 26 May 2001 and 30 June 2001.

28. The minimum subscription under the Prospectus is 200 Woodlots and 200 Units. If the minimum subscription is not received by 11 May 2001, then Plantcorp will, within 14 days after that date, repay each Applicant their Subscription Money, together with any interest earned thereon, without deduction except for bank fees and government charges and the Project will not proceed.

The Project land

29. The Plantation is likely to be located in South Australia and/or Victoria, depending on the location of suitable land for growing radiata pine. Plantcorp currently has an in-principle agreement to purchase two parcels of land situated in the South East of South Australia.

Constitution - Plantcorp 2001 Radiata Pine Project

30. The Constitution provides that Plantcorp will issue a Prospectus which will invite the public to become Growers by subscribing for Woodlots in the Plantcorp 2001 Radiata Pine Project.

31. Each Grower appoints the Responsible Entity, that is Plantcorps as its agent, representative and attorney in relation to the Project with the powers, rights, duties and indemnities set out in the Constitution and the Responsible Entity accepts such appointment.

32. The Application Price of each Woodlot is \$3,883 and forms part of the Subscription Money that each Applicant is required to pay pursuant to the Prospectus.

33. Upon acceptance of an Applicant and if the Minimum Subscription is reached, an Applicant will become a Grower and will be deemed to have become a party to the Constitution. Each Grower will be allotted a Woodlot and is entered as a Grower on the Register of Growers. Plantcorp will also enter into a Licence Agreement and the Management Agreement on behalf of each Grower in accordance with the Power of Attorney granted.

34. The Constitution is binding on all Growers and on Plantcorp.

Constitution - Plantcorp 2001 Radiata Pine Property Trust

35. The Constitution provides that Plantcorp will issue a Prospectus which will invite the public to become Owners by subscribing for Units in the Plantcorp 2001 Radiata Pine Property Trust.

36. Each Owner appoints the Responsible Entity, that is Plantcorp, as Trustee in relation to the Trust with the powers, rights, duties and

indemnities set out in the Constitution and the Responsible Entity accepts such appointment.

37. The Application Price of each Unit is \$2,800 and forms part of the Subscription Money that each Applicant is required to pay pursuant to the Prospectus. As Plantcorp had not acquired land at the time of issuing the Prospectus, Plantcorp has set the cost of a Unit at this amount based on what the Directors consider to be a reasonable price per hectare of suitable land plus the costs associated with purchasing that land. Plantcorp will reimburse Owners within 90 days of commencement of the Project any excess of the funds subscribed for Units in the Trust over the actual cost of acquiring the land. Actual cost will include legal, accounting, statutory and administrative expenses.

38. Upon acceptance of an Applicant and if the Minimum Subscription is reached, Applicants will become an Owner and will be deemed to have become a party to the Constitution. Each Owner will be allotted a Unit and is entered as an Owner on the Register of Owners.

39. The Constitution is binding on all Owners and on Plantcorp.

Custodian Agreement - Plantcorp 2001 Radiata Pine Property Trust

40. The Responsible Entity appoints the Custodian, that is Tower Trust Limited, to hold all of the property of the Trust and any title documents in relation thereto for the benefit of the Responsible Entity.

41. The Custodian must act in accordance with any instructions given to it by the Responsible Entity in accordance with the agreement.

42. The Custodian Agreement is binding upon Tower Trust Limited as the Custodian and Plantcorp as the Responsible Entity.

Management Agreement

43. Growers will enter into a Management Agreement with Plantcorp.

44. Under the Management Agreement, the Grower engages Plantcorp to carry out such Plantation Services as are required to plant, tend, maintain and harvest Trees on the Woodlot in accordance with the Establishment and Maintenance Plan (found in the Management Agreement) and to carry out the Grower's obligations under the Licence.

45. Plantation Services provided include acquiring seedlings on behalf of Growers, establishing and maintaining trees, constructing

and maintaining fire breaks, repairing damage to roads and fences, preventing and combating degradation to Woodlots and taking out public risk insurance.

46. The Grower further engages Plantcorp to sell the wood on behalf of the Grower and for that purpose the Grower will execute a Power of Attorney enabling Plantcorp to act on their behalf in entering into any agreement for the sale of the Grower's wood.

47. Growers are not entitled to assign their interest in the Management Agreement except in certain circumstances.

Licence Agreement

48. Growers will enter into a Licence Agreement with the Custodian, Tower Trust Limited, as owner of the land.

49. Under the Licence Agreement, each Grower is granted a non-exclusive licence to occupy and use the Grower's Woodlot comprising approximately one hectare for the purpose of developing, planting, growing, maintaining and harvesting wood from radiata pine.

50. Under the terms of the Licence Agreement, the Custodian acknowledges and agrees with the Grower that for so long as the Licence has not been terminated, the trees will be and will remain the property of the Grower.

Fees

51. In consideration of the purchase by the Property Trust of the land on which Woodlots are to be established, the fees payable by an Owner per Unit will be as follows:

- \$2800 is payable on lodging the application.

52. In consideration of the services performed and rights granted under the terms of the Management and Licence Agreements, the fees payable by a Grower per Woodlot will be as follows:

- A \$3,850 woodlot preparation and establishment fee is payable on lodging the application, for services provided in the period ending 30 June 2001;
- A \$33 Licence Fee is payable on lodging the application for the period ending 30 June 2001;
- A \$440 woodlot preparation and establishment fee is payable on 1 September 2001, for services provided in the financial year ending 30 June 2002;

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- On 1 May 2002, a \$33 Licence Fee is payable for the period 1 July 2001 to 30 June 2002 and thereafter on 1 May for each successive 12 month period. The fee is to be indexed from June 2001;
- A \$99 woodlot maintenance fee is payable on 1 May 2002 for the period 1 July 2001 to 30 June 2002 and thereafter on 1 May for each successive 12 month period. The fee is to be indexed from June 2001; and
- A \$209 foliage control fee is payable on 1 September 2004, for fertilising and spraying foliar zinc in September/October 2004.

53. Plantcorp will endeavour to arrange insurance against fire and other agricultural risks. The cost is anticipated to be approximately \$12 per Woodlot in the first year, rising throughout the term of the project as the value of the project increases.

54. Plantcorp is entitled to be paid a Harvest management fee of 10% of Proceeds realised from the sale of wood.

55. Plantcorp is entitled to be paid an amount equal to 50% of the net proceeds from the sale of Carbon Credits.

Establishment and maintenance of the Plantation

56. The Prospectus of the project states that the Woodlots will be prepared and established by 30 June 2001 with planting occurring in the income year ending 30 June 2002. Plantcorp anticipates two Plantation thinnings with a final clear felling in year 26.

57. The Management Agreement sets out the duties that Plantcorp will carry out to establish and maintain the Plantation. The Establishment and Maintenance Plan found in the Management Agreement provides a plan and timetable of when these duties will be undertaken.

Finance

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

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

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

- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable income

60. A Grower's share of the gross sales proceeds from the thinnings in Years 13 and 19 of the Project and the Clear Fell in Year 26 of the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Minimum subscription

61. A Grower will not incur the fees shown in the Table below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). A Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 200 Woodlots and 200 Units is achieved. If minimum subscription is not received by 11 May 2001, then Plantcorp will, within 14 days after that date, repay each Applicant their Subscription Money, together with any interest earned thereon, without deduction except for bank

fees and government charges. Tax deductions are not allowable until the minimum subscription requirements are met. If the Project's minimum subscription requirements (described above) are reduced or altered in any way (for example, through the issue of a supplementary Prospectus), this Product Ruling, including the deductions it describes, will have no application to any Grower.

Section 8-1

Deductions where a Grower is not registered nor required to be registered for GST

62. A Grower may claim tax deductions in the Table below where the Grower:

- participates in the Project on or before 25 May 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 51 to 52; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Woodlot preparation & establishment fee	8-1	\$3,850 – See Note (i) (below)	\$440 – See Note (i) (below)	Nil
Annual woodlot maintenance fee	8-1	Nil	\$99 indexed See Note (i) (below)	\$99 indexed See Note (i) (below)
Licence Fee	8-1	\$33 – See Note (i) (below)	\$33 indexed See Note (i) (below)	\$33 indexed See Note (i) (below)
Interest	8-1	See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)
Insurance	8-1	As Incurred	As Incurred	As Incurred

Notes:

- (i) Where a Grower incurs the management fees and the licence fees as required by the Management Agreement and the Licence Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee

MUST be determined using the formula shown in paragraph 95 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 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 101 to 103 below as those rules may be applicable if interest is prepaid.

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

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

- participates in the Project on or before 25 May 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 51 to 52; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 111.

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

Section 35-55 – Commissioner’s discretion

64. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2012 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.

65. 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).

66. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

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

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

68. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Licence Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 90 to 97);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 90 to 97);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 90 to 97);
- 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.

Explanations

Section 8-1

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

- the outgoing 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 timber sales from the project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

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

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

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72. For this Project Growers have rights under the Licence Agreement in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Management Agreement, Growers engage Plantcorp to acquire and plant seedlings on the licenced land and to provide ongoing services to tend, maintain and harvest the trees. Growers are considered to have control of their operations.

73. Under the Licence Agreement, Growers are granted a licence over an identifiable area of land, solely for the purpose of developing, planting, growing, maintaining, harvesting and selling wood. The Land Owner acknowledges that the Growers own the trees on their Woodlot.

74. Growers have the right to use the land in question for afforestation purposes and to have Plantcorp come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over Plantcorp as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on Plantcorp's activities. Growers are able to terminate arrangements with Plantcorp in certain instances, such as cases of default or neglect. The afforestation activities described in the 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. Grower's to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections provided with the application by Plantcorp 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 manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted afforestation 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 for sale. 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 licence fees and management 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 income (from the sale of timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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
- 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 Project 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);

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- (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 interest in the Project is unlikely to pass one of the objective tests or produce a taxation profit until the income year ended 30 June 2013. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

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 ending 30 June 2012.

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

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

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 64), in the manner described in the Arrangement (see paragraphs 14 to 59), 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 this conditional basis, the Commissioner has relied upon:

- the report of the independent forester; and
- independent, objective, and generally available information relating to the afforestation industry.

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

90. 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 licensing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

91. In this Project, the woodlot preparation & establishment fee of \$3,850 and a Licence fee of \$33 per Woodlot will be incurred on execution of the Management Agreement and the Licence Agreement. The woodlot preparation & establishment fee and the Licence fee are charged for providing management services or licensing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the woodlot preparation & establishment 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 woodlot preparation & establishment fee has been inflated to result in reduced fees being payable for subsequent years.

92. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing ‘things’ that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 51 to 52 then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

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

93. Although not required under either the Management Agreement or the Licence Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 92 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.

94. The amount and timing of tax deductions for any prepaid management fees or prepaid licence 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 Grower is a 'small business taxpayer'.

95. 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.

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

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

96. 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 98 to 100) 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 95 above, concerning section 82KZMF.

97. A prepaid management fee and/or a prepaid licence 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 lease fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Subdivision 960-Q - small business taxpayers

98. 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.

99. ‘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).

100. 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

101. 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.

102. 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 sections 82KZME, ‘agreement’ (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

103. 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 use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for a more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same, or effectively the same as that shown above in paragraph 95 above.

Insurance deductibility

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

Section 82KL - recouped expenditure

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

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

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

Part IVA - general tax avoidance provisions

108. 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).

109. The Plantcorp 2001 Radiata Pine Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 62 and 63 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

110. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 – entitlement to 'input tax credit'

111. 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' showing its ABN and the price of the taxable supply for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Detailed contents list

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Commissioner of Taxation

 26 April 2001

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	- forestry
<i>Related Rulings/Determinations:</i>	- interest expenses
TR 92/1; TR 92/20; TD 93/34;	- management fees expenses
TR 97/11; TR 97/16; TR 98/22;	- plantation forestry
PR 1999/95	- primary production
	- primary production expenses
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- schemes and shams
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- Legislative references:*
- ITAA 1936 82KL
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NO 2000/020900

BO

FOI number: I 1025202

ISSN: 1441 1172