


PR 2002/101 - Income tax: 2002 Timbercorp Eucalypts Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 June 2002*



Product Ruling

Income tax: 2002 Timbercorp Eucalypts 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**, **Previous Rulings**, **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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants 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 laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 2002 Timbercorp Eucalypts Project or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - section 8-1 (ITAA 1997);
 - section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZL (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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 taxation

legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. 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 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. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 26 June 2002, 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, 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 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. 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 person's involvement in the arrangement.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2001/134, which is withdrawn on and from the date this Ruling is made (26 June 2002). Product Ruling PR 2001/134 will continue to apply to investors who entered into the Project before 26 June 2002.

Arrangement

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

- Applications for Product Ruling dated 27 April 2001 and 30 May 2002;

- Prospectus for the 2002 Timbercorp Eucalypts Project dated 23 October 2001 ('the Prospectus') prepared for Timbercorp Securities Limited ('TSL'), the Responsible Entity;
- Draft Supplementary Prospectus for the 2002 Timbercorp Eucalypts Project dated 21 June 2002;
- the **Constitution** of the 2002 Timbercorp Eucalypts Project, undated, received on 11 June 2002;
- Draft First **Supplemental Deed** for the 2002 Timbercorp Eucalypts Project received on 22 June 2002;
- Draft **Management Agreement** between each Grower and TSL, undated, received on 24 August 2001;
- Draft **Management Agreement (Post 30 June 2002 Growers)** between each Grower and TSL, undated, received on 7 June 2002;
- Draft **Sub-lease (WA) Agreement** between each Grower and Timbercorp Securities, undated, received on 24 August 2001;
- Draft **Sub-lease (Vic) Agreement** between each Grower and Timbercorp Securities, undated, received on 24 August 2001;
- Draft **Sub-lease (SA) Agreement** between each Grower and Timbercorp Securities, undated, received on 24 August 2001;
- Draft **Sub-lease (WA) Agreement (Post 30 June 2002 Growers)** between each Grower and TSL, undated, received on 7 June 2002;
- Draft **Sub-lease (Vic) Agreement (Post 30 June 2002 Growers)** between each Grower and TSL, undated, received on 7 June 2002;
- Draft **Sub-lease (SA) Agreement (Post 30 June 2002 Growers)** between each Grower and TSL, undated, received on 7 June 2002;
- Draft Plantation Services Agreement between TSL and Timbercorp Treefarms Pty Ltd, dated 27 April 2001;
- Draft Plantation Services Agreement (Post 30 June 2002 Growers) between TSL and Timbercorp Treefarms Pty Ltd, undated, received on 7 June 2002;

- Draft Custody Agreement between TSL and Permanent Trustee Company Limited ('the Custodian'), received on 27 April 2001;
- Draft Pro-forma Lease and Forest Property Agreement between Timbercorp Lands Pty Ltd and TSL, undated, received on 27 April 2001;
- Draft Finance Package dated 27 September 2001; and
- Correspondence from TSL, dated 24 August 2001, 12 September 2001, 1 October 2001, 5 October 2001, 30 May 2002, 3 June 2002, 6 June 2002, 7 June 2002 11 June 2002, 19 June 2002 and 21 June 2002.

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 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 a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called the 2002 Timbercorp Eucalypts Project.

| | |
|--|--|
| Location | South-west Western Australia, south-east South Australia and western Victoria. |
| Type of business each participant is carrying on | Commercial growing and cultivation of <i>Eucalyptus globulus</i> trees (Tasmania Blue Gum) for the purpose of producing timber for wood chipping and for manufacture into premium quality paper. |
| Number of hectares under cultivation | 4,000 which may be increased to allow for oversubscriptions. |
| Number of Woodlots offered | 4, 000 |
| Size of each Woodlot | Net plantable area of 1 to 1.2 hectares. |
| Number of trees per hectare | Between 833 and 1,250. |
| The term of the | 8-12 years. |

PR 2002/101FOI status: **may be released**

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| | |
|---|--|
| Project | |
| Minimum subscription for Project | None. |
| Minimum subscription per Grower | 3 Woodlots (TSL reserves the right to accept applications for less than 3 Woodlots). |
| Fees payable per Woodlot by Early Growers (see paragraph 18) | <p>On subscription - \$3,960.</p> <p>Financial year after subscription date:</p> <ul style="list-style-type: none"> • Balance of plantation preparation and establishment - \$165; • Maintenance fee - \$85.80; • Rent - \$308. |
| Fees payable per Woodlot by Post 30 June Growers (see paragraph 18) | <p>On subscription - \$4,213.</p> <p>Financial year after subscription date:</p> <ul style="list-style-type: none"> • Maintenance fee - \$85.80; • Rent - \$308. |
| Other costs | <ul style="list-style-type: none"> • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, the prescribed proportion of the harvest, delivery and other costs; • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, a harvest supervision /management fee of 3.25% of the net proceeds payable to the Grower; • An amount equal to 1/3 of net proceeds payable to the Grower in excess of net sale proceeds per Woodlot forecast in the Prospectus less allowance for inflation and indexed for CPI; • An amount equal to 1/3 of net proceeds from the sale of the Grower's Carbon Credits; |

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| | |
|----------------|---|
| | <ul style="list-style-type: none"> • Insurance (if Grower chooses to insure). |
| Other Features | Growers may be given an opportunity, between 4 and 10 months before the expiration of the Sub-lease, to participate in a second rotation. |

18. Based on the First Supplemental Deed and Supplementary Prospectus that have been or will be lodged with the Australian Securities and Investments Commission, the Responsible Entity will modify the offer that is being made in the Prospectus and as described in the 'Arrangement' section of PR 2001/134. Under the modified arrangement, investors who subscribe to the offer made in the Prospectus may be accepted as follows:

- Early Growers – Growers in respect of which the Responsible Entity will complete the acquisition of seedlings and the preparation of the land on or before 30 June 2002 and plant eucalyptus seedlings on the Woodlots by 31 August 2002;
- Prepayment Growers – any Grower whose application is received and accepted by the Responsible Entity on or before 30 June 2002 in respect of which the Responsible Entity will complete the Establishment Services after 30 June 2002, but within the initial 12-month establishment period; and
- Post 30 June Growers – Growers whose application is received and accepted by the Responsible Entity on or after 1 July 2002 and before the expiry of the Prospectus.

19. It should be noted that Growers accepted in the year ending 30 June 2002 will only be accepted as either Early Growers or Prepayment Growers if the Responsible Entity decides to set a 'Cut-off Time' which is a date before 30 June 2002. Investors who are accepted on or before the Cut-off time will be accepted as Early Growers while those investors accepted after the Cut-off Time but on or before 30 June 2002 will be accepted as Prepayment Growers.

20. The following description of the arrangement is in respect of the arrangement that will be entered into by Early Growers and Post 30 June Growers. **This Ruling will only apply to Early Growers and Post 30 June Growers.**

21. The 2002 Timbercorp Eucalypts Project is registered as a managed investment scheme under the Corporations Act. Growers entering into the Project will sub-lease land from TSL, in Victoria, South Australia or in Western Australia. The Sub-lease is for a term

expiring on the earlier of 30 June 2015 (for Early Growers), 30 June 2016 (for Post 30 June 2002 Growers) or the completion of harvesting (for all Growers). The minimum area of land leased by each Grower is three identifiable allotments of land of between one and 1.2 hectares which are referred to as Woodlots. TSL reserves the right to accept applications for less than 3 Woodlots.

22. There are 4,000 Woodlots on offer with an option to accept oversubscriptions. TSL, as the Responsible Entity and Project Manager will ensure that, for applicants who subscribe to the Project on or before the Cut-off Time, it will complete the acquisition of seedlings and preparation of land by 30 June 2002.

23. Growers will enter into a Management Agreement with TSL to have a Tasmanian Blue Gum (*Eucalyptus globulus*) plantation established on this leased land for the purpose of eventual felling and sale in 8-12 years. The seedling stocking rate is between 833 and 1,250 trees per hectare. There is the opportunity to participate in a second rotation.

24. The Project will also allow two Growers to enter into a joint venture. They will be bound by the Terms and Conditions of the Joint Venture set out in the Application Form attached to the Prospectus of the Project.

25. Under this Joint Venture:

- one Joint Venture Grower will be responsible for procuring the preparation and establishment of the Woodlots ('first Joint Venture Grower'); and
- the other Joint Venture Grower will be responsible for procuring the ongoing provision of land and maintenance ('second Joint Venture Grower') (cls 4(a) & (b), Terms and Conditions of the Joint Venture).

26. The Terms and Conditions of the Joint Venture provide that each joint venturer will be entitled to a separate, discrete 50% share of the wood to be sold. (cls 5(a) & (b)).

Management Agreement

27. Growers contract with TSL to establish and maintain the plantation until maturity and to harvest and sell the wood on their behalf. The services provided include acquiring seedlings on behalf of Growers, establishing and maintaining the trees, constructing and maintaining firebreaks, repairing damage to roads and fences, preventing and combating degradation of the Woodlots and taking out public risk insurance.

28. Growers execute a Power of Attorney enabling TSL to act on their behalf in entering any agreement for the sale of the Grower's wood.

29. Under the financial hardship provision, Growers can apply to have their remaining annual rent and maintenance fees from year 6 paid by TSL in return for 5% of their sale proceeds for each year in which the costs are paid by TSL. Growers are not entitled to assign the Management Agreement except in certain circumstances.

30. Under the Management Agreement, Growers will be given the option to participate in a Second Rotation and the option may be exercised prior to completion of the First Harvest.

Sub-lease Agreements

31. Growers enter into a Sub-lease Agreement with TSL as sub-lessor. Each of the three alternative Sub-lease Agreements is conditional upon the Grower entering into the Management Agreement. It is also conditional upon TSL receiving approval from the WA Planning Commission (in respect of land in Western Australia) and any local, state or Commonwealth government approvals, if required. Clause 13 of each Sub-lease Agreement grants an interest in the land to the Grower. Growers are not entitled to assign the Sub-lease Agreement except in certain circumstances.

Fees

32. Having regard to the contractual terms of the Management and Sub-lease Agreements, the fees payable by a Grower per Woodlot will be as follows:

Fees payable by Early Growers

- \$3,905 plantation preparation and establishment fee ('Initial management fee') payable in two instalments. \$3,740 for services provided in the period ending 30 June 2002 is payable on lodging the Application and the balance of \$165 for services provided in the year ending 30 June 2003 is payable on 31 October 2002;
- \$220 land rental fee for the period ending 30 June 2002 payable on lodging the Application. Thereafter, the land rental fee is \$308 per Woodlot p.a. payable on 31 October of each year. Commencing 31 October 2003, this fee will be adjusted each year to the greater of the previous year's rent or the amount arrived at by indexation using a formula based on CPI increases and will be payable in respect of the period

1 July to the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance); and

- A maintenance fee of \$85.80 per Woodlot p.a. commencing 31 October 2002 and payable on 31 October of each year in respect of the period 1 July to the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance). The fee will be indexed each year with the first indexation due on 31 October 2003.

Fees payable by Post 30 June Growers

- \$3,905 plantation preparation and establishment fee ('Initial management fee') per Woodlot payable on lodging the Application for services provided in the period ending 30 June 2003;
- \$308 land rental fee per Woodlot for the period ending 30 June 2003 payable on lodging the Application. Thereafter, commencing 31 October 2003, the land rental fee is \$308 per Woodlot p.a. payable on 31 October of each year. This fee will be adjusted each year to the greater of the previous year's rent or the amount arrived at by indexation using a formula based on CPI increases and will be payable in respect of each year ending 30 June (i.e., quarterly in arrears and three quarterly in advance); and
- Commencing 31 October 2003, \$85.80 maintenance fee per Woodlot, payable on 31 October of each year in respect of the period 1 July to the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance). The fee will be indexed each year with the first indexation due on 31 October 2003.

33. TSL will endeavour to arrange fire insurance, with premiums anticipated to be approximately \$11 per Woodlot in the first year increasing to some \$72 per Woodlot at maturity.

34. TSL has appointed a Custodian to receive application moneys and ensure those moneys are applied in accordance with the agreements. TSL will pay the custodian fees.

Planting and Harvesting

35. It is contemplated by the Prospectus that applicants who are accepted as Early Growers will have their Woodlots prepared for planting by 30 June 2002 and will be planted in the income year ending 30 June 2003 and for applicants who are accepted as Post 30 June Growers will have their Woodlots fully established in the

income year ending 30 June 2003. The Independent Forester's Report sets out the details of the plantation establishment and management activities to be undertaken. These include, among others, selection of seed, seedlings, site preparation, planting method, subsequent plantation care and silvicultural tending of the plantation. The Management Plan provides a timetable when these activities will be undertaken. TSL will sub-contract all plantation establishment and maintenance functions to Timbercorp Treefarms Pty Ltd, a related company. TSL will provide ongoing reports to the Growers on the progress of the plantations.

36. The harvest period for applicants who are accepted as Early Growers is between 30 September 2010 and 30 September 2014 and for applicants who are accepted as Post 30 June Growers the harvest period is between 30 September 2011 and 30 September 2015. TSL will be responsible for arranging the marketing, harvesting and sale of the wood, with the Grower kept informed of the details, including proposed purchase price and harvesting and delivery costs. One of the assumptions used in the financial forecasts shown in the Prospectus is that Trees from the Woodlots will be harvested 10 years after planting.

Finance

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

38. Various finance options are offered by Timbercorp Finance Pty Ltd. The interest rate depends on the term of the loan. Security is over the Grower's interest in the Project, i.e., the Woodlots and the entitlement to wood proceeds. The loan is repayable by equal monthly instalments of principal and interest and is provided on a full recourse basis. Legal action will be taken over any outstanding repayments.

39. The Custodian will be custodian of the application moneys, including loan funds if the finance option is taken, and ensure those moneys are applied in accordance with the agreements.

40. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution other than Timbercorp Finance Pty Ltd for the provision of any finance to the Growers for any purpose associated with the Project.

41. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

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

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

Ruling

Application of this Ruling

42. This Ruling applies only to Growers who are accepted to participate in the Project either:

- in the year ended 30 June 2002, on or before the Cut-off Time, where the Grower has executed a Management Agreement and a Sub-lease Agreement on or before that date; and/or
- in the year ended 30 June 2003, on or after 1 July 2002 and before the expiry of the Prospectus, where the Grower has executed a Management Agreement and a Sub-lease Agreement before the expiry of the Prospectus.

43. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

44. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

45. This Ruling does not consider the deductibility or otherwise of fees relating to a second rotation (see paragraph 30).

The Simplified Tax System ('STS') - Division 328

46. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

47. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

48. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

49. The Grower recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

Deductions for Initial management fee, rent, maintenance fee and interest**Section 8-1**

50. A Grower who is not an 'STS taxpayer' and who **is not** a Joint Venture Grower (as explained in paragraphs 24 to 26) may claim tax deductions for the following revenue expenses:

Deductions for Early Growers

| Fee Type | ITAA 1997 Section | Year ended 30/6/2002 | Year ended 30/6/2003 | Year ended 30/6/2004 |
|------------------------|--------------------------|--------------------------------------|--------------------------------------|--|
| Initial management fee | 8-1 | \$3,740 – See Notes (i) & (ii) below | \$165 – See Notes (i) & (ii) below | nil |
| Rent | 8-1 | \$220 – See Notes (i) & (ii) below | \$308 – See Notes (i) & (ii) below | \$308 – See Notes (i), (ii) & (iv) below |
| Maintenance fee | 8-1 | nil | \$85.80 – See Notes (i) & (ii) below | \$85.80 – See Notes (i), (ii) & (iv) below |
| Interest | 8-1 | As incurred – See Note (iii) below | As incurred – See Note (iii) below | As incurred – See note (iii) below |

PR 2002/101*Deductions for Post 30 June Growers*

| Fee Type | ITAA 1997 Section | Year ended 30/6/2002 | Year ended 30/6/2003 | Year ended 30/6/2004 |
|------------------------|----------------------------------|---------------------------------|--------------------------------------|--|
| Initial management fee | 8-1 | nil | \$3,905 – See Notes (i) & (ii) below | nil |
| Rent | 8-1 | nil | \$308 – See Notes (i) & (ii) below | \$308 – See Notes (i), (ii) & (iv) below |
| Maintenance fee | 8-1 | nil | nil | \$85.80 – See Notes (i), (ii) & (iv) below |
| Interest | 8-1 | nil | As incurred – see Note (iii) below | As incurred – see Note (iii) below |

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example at paragraph 125;
- (ii) The Initial management fee, maintenance fee and rent shown in the Management Agreement and the Sub-lease Agreement are deductible in full in the year that they are incurred. However, if a Grower chooses to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 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' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded

expenditure' refers to an amount of expenditure of less than \$1,000;

- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 92 to 99 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice;
- (iv) These amounts do not allow for indexation.

51. A Grower who is not an 'STS Taxpayer' but who **is** a Joint Venture Grower (as explained in paragraphs 24 to 26) may claim deductions for the following amounts set out in the table and Notes above:

- (i) the **first** Joint Venture Grower referred to in paragraph 25 may claim deductions for amounts incurred for the Initial management fee and for any interest incurred on funds borrowed from Timbercorp Finance Pty Ltd; and
- (ii) the **second** Joint Venture Grower referred to in paragraph 25 may claim deductions for amounts incurred for Rent, maintenance fee and for any interest incurred on funds borrowed from Timbercorp Finance Pty Ltd.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

52. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

53. The Grower recognises ordinary income from carrying on the business of afforestation at the time the income is received (paragraph 328-105(1)(a)).

PR 2002/101**Deductions for Initial management fee, rent, maintenance fee and interest****Section 8-1 and section 328-105**

54. A Grower who is an 'STS taxpayer' and who **is not** a Joint Venture Grower (as explained in paragraphs 24 to 26) may claim tax deductions for the following revenue expenses:

Deductions for Early Growers

| Fee Type | ITAA 1997 Sections | Year ended 30/6/2002 | Year ended 30/6/2003 | Year ended 30/6/2004 |
|------------------------|---------------------------|--|--|---|
| Initial management fee | 8-1 & 328-105 | \$3,740 – See Notes (v), (vi) & (vii) below | \$165 – See Notes (v), (vi) & (vii) below | nil |
| Rent | 8-1 & 328-105 | \$220 – See Notes (v), (vi) & (vii) below | \$308 – See Notes (v), (vi) & (vii) below | \$308 – See Notes (v), (vi), (vii) & (ix) below |
| Maintenance fee | 8-1 & 328-105 | nil | \$85.80 – See Notes (v), (vi) & (vii) below | \$85.80 – See Notes (v), (vi), (vii) & (ix) below |
| Interest | 8-1 & 328-105 | As incurred and paid – See Note (viii) below | As incurred and paid – See Note (viii) below | As incurred and paid – See Note (viii) below |

PR 2002/101FOI status: **may be released**

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Deductions for Post 30 June Growers

| Fee Type | ITAA 1997 Section | Year ended 30/6/2002 | Year ended 30/6/2003 | Year ended 30/6/2004 |
|------------------------|----------------------------------|---------------------------------|--|---|
| Initial management fee | 8-1 & 328-105 | nil | \$3,905 – See Notes (v), (vi) & (vii) below | Nil |
| Rent | 8-1 & 328-105 | nil | \$308 – See Notes (v), (vi) & (vii) below | \$308 – See Notes (v), (vi), (vii) & (ix) below |
| Maintenance fee | 8-1 & 328-105 | nil | nil | \$85.80 – See Notes (v), (vi), (vii) & (ix) below |
| Interest | 8-1 & 328-105 | nil | As incurred and paid – See Note (viii) below | As incurred and paid – See Note (viii) below |

Notes:

- (v) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example at paragraph 125.
- (vi) If, for any reason, an amount shown in the table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the table above, which is not paid in the year in which it is incurred, will be deductible in the year in which it is actually paid.
- (vii) Where a Grower who is an 'STS taxpayer', pays the Initial management fee, maintenance fee and rent shown in the Management Agreement and the Sub-lease Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (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, the prepayment 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' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

- (viii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, the internal financier is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraph 92 to 99 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.
- (ix) These amounts do not allow for indexation.

55. A Grower who is an 'STS Taxpayer' but who **is** a Joint Venture Grower (as explained in paragraphs 24 to 26) may claim deductions for the following amounts set out in the table and Notes above:

- (i) the **first** Joint Venture Grower referred to in paragraph 25 may claim deductions for amounts incurred and paid for the Initial management fee and for any interest incurred and paid on funds borrowed from Timbercorp Finance Pty Ltd; and
- (ii) the **second** Joint Venture Grower referred to in paragraph 25 may claim deductions for amounts incurred and paid for Rent, maintenance fee and for any interest incurred and paid on funds borrowed from Timbercorp Finance Pty Ltd.

Tax outcomes that apply to all Growers

Section 35-55 – Deferral of losses from non-commercial business activities

Section 35-55 – Commissioner’s discretion

56. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 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 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.

57. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 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 2003 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.

58. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 110 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

59. Where, the ‘exception’ in subsection 35-10(4) applies, the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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.

60. 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 commercially viable. An

assessment of the Project or the product from this perspective has not been made.

Sections 82KZME – 82KZMF, 82KL and Part IVA

61. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Sub-lease Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 92 to 99);
- 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

Is the Grower carrying on a business?

62. For the amounts set out in the tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the 2002 Timbercorp Eucalypts Project must amount to the carrying on of a business of primary production.

63. Where there is a business, or a future business, the gross sales proceeds from the sale of the wood produce from the Woodlots comprising 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.

64. For schemes such as that of the 2002 Timbercorp Eucalypts Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929; 16 ATR 55.

65. Generally, a Grower will be carrying on a business of afforestation, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the wood produce from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

66. In this Project, each Grower enters into a Management Agreement and a Sub-lease Agreement.

67. Under the Sub-lease Agreement, each individual Grower will have rights over a specific and identifiable area of land. The Sub-lease Agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Sub-lease, the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Sub-lease allows TSL to come onto the land to carry out its obligations under the Management Agreement.

68. Under the Management Agreement TSL is engaged by the Grower to establish and maintain a Woodlot on the Grower's identifiable area of land during the term of the Project. TSL has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Woodlot on the Grower's behalf.

69. TSL is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Woodlot.

70. 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 Project's description for all the indicators.

71. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the wood produce that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

72. The pooling of wood produce from trees grown on the Grower's Woodlot with the wood produce of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled wood products will reflect the proportion of the trees contributed from their Woodlot.

73. TSL's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

74. The Grower's degree of control over TSL as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, TSL will provide the Grower with regular progress reports on the Grower's Woodlot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with TSL in certain instances, such as cases of default or neglect.

75. 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. For the purposes of this Ruling, the Grower's afforestation activities in the 2002 Timbercorp Eucalypts Project will constitute the carrying on of a business.

The Simplified Tax System - Division 328

76. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

77. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Initial management fee, rent and maintenance fee

Section 8-1

78. Consideration of whether Initial management fee, rent and maintenance fee 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 is contractually committed 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.

79. The Initial management fee, rent and maintenance fee associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of wood produce) 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.

Possible application of prepayment provisions

80. Under the Management Agreement and the Sub-lease Agreement neither the Initial management fee, rent nor maintenance fee are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

81. However, where a Grower **chooses** to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 92 to 99) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Timing of deductions

82. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the lease fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

83. If the Grower is not an 'STS taxpayer', the Initial management fee, rent and maintenance fee are deductible in the year in which they are incurred.

84. If the Grower is an 'STS taxpayer', the Initial management fee, rent and maintenance fee are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility - section 8-1

(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider

85. Some Growers may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Initial management fee, rent and maintenance fee.

86. The interest incurred for the year ended 30 June 2002 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing of trees and the lease of the land on which the trees will have been planted - that will continue to be 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.

87. As with the Initial management fee, rent and maintenance fee, in the absence of any application of the prepayment provisions (see paragraphs 92 to 99), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

88. If the Grower is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

89. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Grower. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid, or is paid for the Grower.

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

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

91. 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. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 92 to 99).

Prepayment provisions - sections 82KZL to 82KZMF

92. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. 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 will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

93. For this Project only section 82KZL (an interpretive provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

94. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure

is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

95. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

96. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than Timbercorp Finance Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

97. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

98. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

99. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

100. In this Project:

- for subscribers accepted as Early Growers into the Project, part of the initial management fee which amounts to \$3,740 per Woodlot and an initial rent of \$220 per Woodlot; and
- for subscribers accepted as Post 30 June Growers, initial management fee of \$3,905 and an initial rent of \$308,

will be incurred on execution of the Management Agreement and the Sub-lease Agreement. The initial management fee and rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

101. In particular, the initial management 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 initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

102. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for TSL doing 'things' that are not to be wholly done within the expenditure year. Under the Sub-lease Agreement, rent is payable annually on 31 October for the lease of the land from 1 July to 30 June during the expenditure year. Similarly, under the loan agreements to be executed between Growers and Timbercorp Finance Pty Ltd interest is payable monthly in arrears.

103. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 32, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

104. Although not required under either the Management Agreement, the Sub-lease Agreement, or the Loan Agreement with Timbercorp Finance Pty Ltd, a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Growers who use financiers other than Timbercorp Finance Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 103 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

105. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid rent, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

106. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Deferral of Losses from non-commercial business activities - Division 35

107. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the 'exception' in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

108. 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.

109. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

110. For the purposes of applying Division 35, 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.

111. In broad terms, the 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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

112. 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 an Early Grower who acquires the minimum allocation of three Woodlots is unlikely to have their activity pass one of the tests until the income year ended 30 June 2012 while a Post 30 June Grower who acquires the minimum allocation of three Woodlots is unlikely to have their activity pass one of the tests until the income year ended 30 June 2013. Any Grower who acquires one Woodlot is unlikely to ever pass one of the tests.

113. Therefore, 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.

114. 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, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised where the business activity has started to be carried on and for that, or those income years:

- (i) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (ii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

115. Information provided with this Product Ruling application indicates that an Early Grower who acquires the minimum allocation of three Woodlots in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2012 while a Post 30 June Grower is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2013. An Early Grower or a Post 30 June Grower who acquires one Woodlot is also expected to be carrying on a business activity that will produce taxation profit in the income years ended 30 June 2012 and 30 June 2013, respectively.

116. The Commissioner will decide for such Early and Post 30 June Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2011 and 30 June 2012, respectively.

117. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraphs 56 and 57) in the manner described in the Arrangement (see paragraphs 15 to 41). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

118. 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:

- Independent Forester's Report; and
- independent, objective, and generally available information relating to the afforestation industry.

Section 82KL – recouped expenditure

119. 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’.

120. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received 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.

121. Section 82KL’s operation depends, among other things, on the identification of ‘additional benefit(s)’. 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 anti-avoidance provisions

122. 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).

123. The 2002 Timbercorp Eucalypts Project will be a ‘scheme’. A Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 50, 51, 54 and 55, 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.

124. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the wood produce. 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 at arm’s length or, if any parties are not dealing 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 – Entitlement to GST input tax credits

125. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002 \$4 400*

| | |
|--|-----------------|
| Carrying out of upgrade of power for your vineyard as quoted | <u>\$2 200*</u> |
| Total due and payable by 1 January 2002 (includes GST of \$600) | <u>\$6 600</u> |

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 *less* \$200, or \$2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4000 (not \$4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2000 only, not one tenth of \$2200).

Detailed contents list

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Commissioner of Taxation

26 June 2002

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/1; TR 92/20; TD 93/34;
 TR 97/11; TR 97/16; TR 98/22;
 TR 2000/8; PR 1999/95; IT 360

Subject references:

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

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Case references:

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