



PR 2002/115 - Income tax: Timber Capital Plantation 1997 Prospectus

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Product Ruling

Income tax: Timber Capital Plantation 1997 Prospectus

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

Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. 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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 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. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

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 Timber Capital Plantation 1997 Prospectus or simply as 'the Project'.

Tax laws

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

Goods and Services Tax

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

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 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 those persons who are more specifically identified in the Ruling part of this Product Ruling and who were accepted into the Project on or after 25 February 1997 but before 24 February 1998. 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 have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. 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 2 October 2002 for Growers who, on or after 25 February 1997 but before 24 February 1998, entered into the specified arrangement that is set out below. 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 2003. The Ruling continues to apply, even following its withdrawal, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement that is set out below on or after 25 February 1997 but before 24 February 1998. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Applications for Product Rulings dated 20 December 2001 and 31 January 2002;
- Timber Capital Plantation 1997 Prospectus dated 25 February 1997 ('the Prospectus');
- **Deed establishing the Timber Capital Plantation Project** dated 13 April 1995 ('the Project Deed') between Timber Capital Limited ('TCL') and Burke Bond Queensland Limited;
- First Supplemental Deed dated 4 April 1996;
- **Proforma Lease Agreement** between TCL and the Grower;
- **Proforma Preparation & Planting Agreement** between TCL and the Grower;
- **Proforma Maintenance Agreement** between TCL and the Grower;
- **Proforma Loan Agreement** between A.S. Calendar Nominees (Vic.) Pty Ltd and the Grower; and

- Correspondence and attachments from Willmott Forests Limited and its Taxation Advisors dated 16 April 2002, 29 July 2002 and 21 August 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.

15. The documents highlighted are those which Growers entered into or became a party to. The Loan Agreement was executed where a Grower successfully applied for finance from A.S. Calendar Nominees (Vic.) Pty Ltd. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, was or is a party to.

Overview

16. This arrangement is called the Timber Capital Plantation 1997 Prospectus.

Location	Bombala and Ando, New South Wales
Type of business each participant is carrying on	Commercial forestry
Tree species	<i>Pinus radiata</i>
Minimum number of Hectares than can be subscribed for	1 Hectare
Minimum number of trees per Hectare	1,000
Term of Project	25 years
Initial cost per hectare	\$13,500
Other costs to Growers	Fire insurance premiums after year 10 if a Grower so desires. Growers will also incur harvesting / marketing costs.

17. Growers participating in the Project entered into a Lease Agreement, Preparation & Planting Agreement and a Maintenance Agreement. Growers leased an area of land called a 'Hectare' from TCL for 25 years. Growers must have applied for a minimum of 1 Hectare.

18. Subscription to the Project was offered through the Prospectus which was lodged with the then Australian Securities Commission

(now, the Australian Securities and Investments Commission or ASIC). All ASIC requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Lease Agreement

19. The Lease was granted by TCL ('lessor') to Growers ('lessee') under the terms of the Lease Agreement. Growers were granted an interest in land in the form of a lease to use their Hectare for the purposes of conducting their afforestation business, including the right to harvest timber grown on the Hectare. The lease is for 25 years and may be extended by 5 years or until such time as the trees have been harvested and the land made good, whichever is the sooner.

20. The lessee shall not use the land jointly with anyone else and retains the right to say when the trees are to be planted. If the lessee breaches any conditions, the lessor may enter the land to remedy the breaches at cost to the lessee. If the lessee defaults, the lessor can re-enter the land. Re-entry by the lessor ends the lease but the lessor retains all rights under the general law including the right to sue the lessee for unpaid money or for damages for breaches of the lessee's obligations under the lease.

Preparation & Planting Agreement

21. A Preparation & Planting Agreement was entered into between TCL ('the Manager') and each Grower. In accordance with this agreement, the Manager must have completed the site preparation and initial development works within 13 months of signing this agreement. This agreement also provides that the Manager could delegate its responsibilities.

22. The Preparation & Planting Agreement summarised the works and services that were undertaken by the Manager and these were as follows:

- (i) Site preparation and fencing;
- (ii) Initial development works including
 - Surveyors fees in field work, setting out fire breaks and access ways,
 - Removal of bracken fern and undergrowth ready for ripping and/or ploughing,
 - Weedicide treatments as required,
 - Supplying and planting pinus radiata seedlings at an average of 1000 per hectare,

- Constructing access roads and firebreaks including general supervision, and
 - Consultant Forester's fees and expenses for first year;
- (iii) Sundries
- Fire Insurance for first year of Project for replacement cost, and
 - Public Risk Insurance for first year of Project, \$5,000,000.00.

Maintenance Agreement

23. A Maintenance Agreement was entered into between TCL ('the Manager') and each Grower in respect of the works and services to be undertaken by TCL after the first year of the Project. This agreement also provides that the Manager could delegate its responsibilities. These works and services are as follows:

- (i) Establishment work
- Second year after planting, including replanting where required, treatment of regrowth, fertilising, attention to access roads and firebreaks and general maintenance,
 - Third year, general maintenance, including attention to regrowth, access roads and firebreaks, and
 - Fourth year, general establishment work and maintenance including attention to regrowth, access roads and firebreaks;
- (ii) General maintenance
- Fifth to twenty-fifth year, further fertilising, general maintenance including attention to regrowth and firebreaks; and
- (iii) Sundries
- Fire insurance for period of 9 years from the second year of the project to tenth year of the project, (both inclusive), and
 - Public Risk Insurance for period from the second year of the Project to the twenty-fifth year, \$5,000,000.00.

Harvesting and Marketing

24. Harvesting of the trees and marketing of timber are the Grower's decision. The Grower may engage the Manager to arrange for these services to be carried out at the appropriate time or make other arrangements to harvest and market the timber. The Manager's fees for doing so will be 5% of net proceeds from timber sales. Harvesting is anticipated to be undertaken in years 16 (1st thinning), 20 (2nd thinning) and 25 (Clear fell).

Deed establishing the Timber Capital Plantation Project ('Investment Deed')

25. The Investment Deed sets out the terms and conditions under which Burke Bond Queensland Limited agrees to act as Representative of the Growers. The Investment Deed also deals with the establishment and operation of a Future Maintenance Account. According to the Prospectus, the funds in this account will progressively become available to the Forest Manager, Willmott Forest Management Ltd, after year 10 to ensure the development of the Project to maturity and it is intended that this account will be overseen by the Representative and audited annually.

Project Fees

26. The fees as provided in the agreements entered into by Growers are as follows:

- Lease Agreement \$4,000 / Ha;
- Preparation & Planting Agreement \$6,000 / Ha; and
- Maintenance Agreement \$3,500 / Ha.

Total \$13,500 / Ha

Finance

27. Growers may have funded their participation in the Project themselves, borrowed from an independent lender or borrowed from A.S. Calendar Nominees (Vic.) Pty Ltd, an associate of the Manager ('the Lender').

28. Based on the Prospectus, a Grower who applied for finance from the Lender must have completed the Loan Application Form and paid the Loan Establishment Fee of \$120 which is 1% of the amount borrowed. The amount that was subject to finance was \$12,000 per hectare at 10% interest rate per annum.

29. The Loan Agreement provides that the term of the loan is 10 years. Growers are or were required to make an equal monthly interest payment for ten (10) years and at the end of the ten-year term the principal amount must be paid ('principal repayment date'). However, the Loan Agreement provides that the Lender can extend and/or vary the principal repayment date in accordance with any of the following options:

- extend the principal repayment for a period of 5 years with the Grower agreeing to pay interest only on terms and conditions and interest to be set by the Lender; or
- extend the term of the loan for a period of 5 years with the Grower agreeing to reduce the loan by payments to cover both principal and interest and at an interest to be set by the Lender; or
- defer the repayment of the principal until Clear fell provided that 25% of the Grower's interest is assigned to the Financier ('Deferment Option'). **This Product Ruling does not apply to Growers who choose the Deferment Option.**

30. The terms of the loan provide that security was given over the Grower's interest in the Project including the Hectares allocated to that Grower. If a Grower defaults, the Lender will demand payment and if the demand is not complied with, the Lender will sell the Grower's interest. The Grower will pay on demand the amount of any deficiency in any loan money and interest after such sale and all costs and expenses incurred by or on behalf of the Lender in exercising its rights arising from that Grower's default.

31. 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 A.S. Calendar Nominees (Vic.) Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

32. This Product Ruling applies to Growers:
- who do not choose the Deferment Option (see paragraph 29 above); and
 - who will engage the Manager to arrange for the harvesting of the trees and marketing of timber.

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

Section 35-55 – Commissioner’s discretion

33. For a Grower who is an individual and who entered the Project on or after 25 February 1997 but before 24 February 1998 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 2021 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.

34. 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 40 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)).

35. 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.

36. 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.

Explanations

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

37. 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.

38. 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.

39. 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

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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.

40. 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.

41. 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).

42. A Grower participating in the Project is 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 acquired the minimum allocation of one Hectare is unlikely to have their activity pass one of the tests until the income year ended 30 June 2022. Growers who acquired more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

43. 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.

44. 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.

45. Information provided with this Product Ruling application indicates that a Grower who acquired the minimum allocation of one Hectare 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 2022 or will produce a taxation profit, for the income years ended 30 June 2013 and 30 June 2017.

46. The Commissioner will decide for such a 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 2021. The taxation profit that is projected for the income years ended 30 June 2013 and 30 June 2017 do not affect the period of the Commissioner's discretion as they are considered to be 'one-off' events that are specific to the afforestation industry.

47. The applicant has stated that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 14 to 31 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 33), in the manner described in the arrangement, this Ruling may be affected. 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.

48. 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 Consultant Forester's Reports provided with the application;
- Grower's Report 2001; and
- independent, objective, and generally available information relating to the afforestation industry.

Detailed contents list

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

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Commissioner of Taxation2 October 2002

Previous draft:

Not previously issued in draft form

*Related Rulings/Determinations:*TR 92/1; TR 92/20; TD 93/34;
TR 97/16; TR 98/22; PR 1999/95*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

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1936 Part IVA
- ITAA 1936 82KL
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)

ATO references:

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