



PR 2002/119 - Income tax: Mount Kincaid 1999 Bluegum Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 October 2002*

Product Ruling

Income tax: Mount Kincaid 1999 Bluegum Project

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Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. 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 relates. In this Ruling this arrangement is sometimes referred to as the Mt. Kincaid 1999 Bluegum Project, 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 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 were accepted into the project between 1 May 1999 and 30 June 1999. They will have a purpose of staying in the arrangement until it is completed (ie. 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 from 23 of October 2002 for Growers who, between 1 May 1999 and 30 June 1999, 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 between 1 May 1999 and 30 June 1999. 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 described below. This description incorporates the following documents:

- Application for a Product Ruling, dated 28 May 2001;
- Mt. Kincaid 1999 Bluegum Project Information Booklet and attached Appendices, prepared for Green Triangle Forests Pty. Ltd. A.C.N. 087 537 059 including;
 - **Project Development and Administration Agreement;**
 - **Joint Venture Agreement;**
 - **Forest Property Agreement;**
- The Green Triangle Tree Farm Grower Agreement dated 3 August 1999 and Deed of Amendment Dated 25 May 2001.

Note: certain information received from the applicant 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 that the Growers entered into. 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.

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

Overview

17. The arrangement is called the Mt Kincaid 1999 Bluegum Project.

Location	80 km south-east of Mount Gambier and approx. 26 km north-west of Portland (The Green Triangle)
Type of business each participant is carrying on	Commercial growing and cultivation of Eucalyptus globulus (bluegum) trees for woodchipping
Number of hectares under cultivation	150 hectares
Minimum application	1 Woodlot
Number of Woodlots	20
Size of each Woodlot	7.5 hectares
Number of trees	1100 per hectare
Expected Production	270 tonnes per hectare (in Year 10 and Year 17)
Term of investment	Stage 1: 10 years Stage 2: +7 years
Initial cost per woodlot	\$21 870 development fees plus a further charge for fertilising in Year 6 if required. (approx. \$2000)
Ongoing Costs	Annual Licence Fee \$300 per hectare indexed by CPI annually. Management Fee \$80 per hectare indexed by CPI annually

18. Growers participating in the project entered into a Forest Property Agreement, a Project development and Administration Agreement and a Joint Venture Agreement. These agreements are set out in schedules to the Information Booklet. The Forest Property Agreement gives the grower a licence over an identifiable area of land called a Woodlot subject to the covenants of the agreement until the project is terminated. Each Woodlot is 7.5 hectares in size.

19. The Project is being conducted on a site at Mt. Kincaid, located approximately 80 km south east of Mt. Gambier and approximately 26km north west of Portland via Mt. Gambier to Portland Road. It is situated in the area known as the Green Triangle. A grower participated in the project by:

- Entering into a 'Forest Property agreement' with the land owner, GEBD Nominees Pty. Ltd. as Trustee for the Mt. Kincaid Trust, with respect to a Woodlot (7.5 hectares) for the period to the first harvest or 14 June 2012, whichever is the earliest;
- Entering into a 'Project Development and Administration Agreement' with Green Triangle Forests Pty. Ltd. as Trustee for the Green Triangle Forests Trust, the project Administrator, to establish and develop the bluegum plantation; and
- Entering into a 'Joint Venture Agreement' with other woodlot owners, the Project Administrator and the Land Owner, whereby woodlot owners appoint the Project Administrator as their agent to enter into and perform the Green Triangle Treefarm Grower Agreement. Thus, agreeing to pool the timber harvested from the woodlots for sale at the first harvest.

20. A grower entering into the Forest Property Agreement was liable to pay the following amounts for a right to use the woodlot for afforestation:

- Annual licence fee commencing 15 June 1999 of \$2,250 (being \$300/ha), and for every year of the remainder of the agreement this fee indexed by the CPI..

21. A Grower entering into the Project Development and Administration Agreement was liable to pay the following amounts in respect of each Woodlot:

- Development fees payable on or before 15 June 1999 of \$21,870;
- Fertiliser fees of \$2,000 for year ended 15 June 2005, which will be adjusted to lesser amount if less fertiliser is required, payable by 15 June 2005;
- Annual administration and management fee commencing 15 June 1999 of \$600, and for every year of the remainder of the agreement this fee indexed by the CPI.

Forest Property Agreement

22. Each participant (woodlot owner/grower) enters into a Forest Property Agreement, with the land owner, GEBD Nominees Pty. Ltd. and pay and annual licence fee for the right to use the land for their

afforestation business. The term of the Agreement will be until the first harvest with an option to renew for the second harvest.

23. The total plantable area will be divided into 20 woodlots of approximately equal proportions. Participants will enter into a Forest Property Agreement for a minimum of 1 woodlot (approximately 7.5 hectares of plantable area).

Project Development and Administration Agreement

24. Each participant enters into a Project Development and Administration Agreement with Green Triangle Forests Pty. Ltd., the Administrator, to establish and develop the bluegum plantation in accordance with the agreement.

25. The project Administrator, on behalf of the Woodlot owner will administer and manage the business of the Woodlot and the plantation subject to this agreement and the Joint Venture Agreement.

26. To establish and develop the planting, woodlot owners will be required to pay development fees to the administrator.

Joint Venture Agreement

27. Participants, being the woodlot owners, the Project Administrator and the Land owner enter into the Joint Venture Agreement, whereby the woodlot owners appoint the Project Administrator as their agent to enter into and perform the Green Triangle Treefarm Grower Agreement to pool the timber harvested from the woodlots for sale at the first harvest.

28. The Administrator in its capacity as agent for the growers will sign an agreement named the Green Triangle Treefarm Grower Agreement (GTTGA) to sell the Eucalyptus grown on the woodlots for pulpwood. The Grower Agreement is at Appendix VIII of the Information Memorandum. As part of the GTTGA, a base price of \$38 per tonne (net of harvesting and transport costs) has been negotiated. This price is linked to the Tasmanian Old Growth Export Woodchip Price Index.

Compliance plan

29. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Act. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the responsible entity and the rights of the Growers are protected.

Minimum Subscription

30. The minimum number of Woodlots required for the commencement of the Project was twenty (20) Woodlots.

Finance

31. Growers are entitled to fund their involvement in the Project themselves, or borrow from an independent lender.

32. 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 are involved or become involved in the provision of finance to Growers for the Project.

Ruling

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 enters the Project between 1 May 1999 and 30 June 1999 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 2007 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, ie, 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 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, or an interest in real property, (excluding any private dwelling) 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 who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of 1 woodlot in the Project is unlikely to have their activity pass one of the tests until the

income year ended 30 June 2008. Growers who acquire 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 by the Commissioner where the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- 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 indicates that a Grower who acquires the minimum investment of 1 woodlot 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 2008.

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 2007.

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 32 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 report of the independent forester and additional expert or scientific evidence provided with the application by the Responsible Entity;
- the binding pulpwood contract for the sale of the pulpwood, setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the Eucalyptus are grown.

Detailed contents list

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

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Commissioner of Taxation23 October 2002

Previous draft:

Not previously released in draft form

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

- product rulings
- public rulings
- non-commercial losses
- primary production expenses

- 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)
- Copyright Act 1968
- TAA 1953 Pt IVAAA

Legislative references:

- ITAA 1936 Part IVA
- ITAA 1936 82KL
- ITAA 1997 Div 35

ATO references:

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