



PR 2002/140 - Income tax: Northern Softwood Project 2003

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 This document has changed over time. This is a consolidated version of the ruling which was published on 4 December 2002



Product Ruling

Income tax: Northern Softwood Project 2003

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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.

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 'Northern Softwood Project 2003' 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);
 - Section 82KZMG (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. Growers who elect to harvest and market their own Plantation Produce (see paragraphs 22, 37 and 54) are excluded from the class of persons to whom this Ruling applies.

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 4 December 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 2005. 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.

Arrangement

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

- Application for Product Ruling, dated 2 September 2002;
- **Draft New South Wales Planted Forests Information Memorandum, prepared and issued by Arrow Capital Pty Limited ('Arrow'), dated 7 June 2002;**
- **Draft Forestry Management Agreement ('the Agreement') between the Grower and Australian Forestry Management Pty Limited ('the Manager'), received 4 September 2002;**
- **Draft Forestry Right between Forestry Commission of New South Wales and the Grower, dated 24 June 2002;**
- Draft Contract for Forestry Management between Australian Forestry Management Pty Limited and Forestry Commission of New South Wales ('State Forests'), received 4 September 2002;
- **Draft Deed of Loan between the Borrower, the Guarantor and NM Rothschild & Sons (Australia) Limited ('the Lender'), received 20 November 2002;**
- **Mortgage Memorandum of Forestry Right - Annexure A between the Borrower and NM Rothschild & Sons (Australia) Limited ('the Lender'), received 4 September 2002;**
- **Loan Application Form NM Rothschild & Sons (Australia) Limited to be completed by the Applicant, received 4 September 2002;**
- Manager Tri-Partite Deed between Australian Forestry Management Pty Limited ('the Manager') and NM Rothschild & Sons (Australia) Limited ('the Lender'), received 4 September 2002;
- State Forests Tri-Partite Deed between Forestry Commission of New South Wales ('State Forests') and NM Rothschild & Sons (Australia) Limited ('the Lender'), received 4 September 2002;
- Independent Forester's Reports, dated 2 June 2002 and 18 June 2002;

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- Directors Undertaking, dated 18 November 2002; and
- Additional correspondence received from the applicant, dated 2 October 2002, 16 October 2002, 29 October 2002, 6 November 2002, 14 November 2002, 18 November 2002 and 20 November 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 that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

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

17. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client. **This Ruling does not apply unless** the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*.

18. The meaning of a wholesale client is explained in paragraphs 69 to 74 in the Explanations area of this Product Ruling.

Overview

19. The arrangement is called the Northern Softwood Project 2003.

Location	3 properties – Barragunda, Yaraldi and Wandali – located between Casino and Grafton in NSW.
Type of business each participant is carrying on	Commercial growing, and cultivation of F2 of <i>Pinus elliottii</i> var. <i>elliottii</i> x <i>Pinus caribaea</i> var. <i>hondurensis</i> (second-generation Slash pine x Caribbean pine hybrid) for the purpose of acquiring proceeds from the sale of Timber and Plantation Produce.
Number of hectares to be under cultivation	1,900 hectares.
Minimum subscription required for the Project to proceed	10 Units.
Minimum subscription pre Grower	1 Unit.
Size of each Unit	50 hectares.
Number of trees per hectare	Approximately 1,000 per hectare.
Term of the Project	A minimum of 25 years.
Initial cost per Unit	\$178,750
Initial cost per hectare	\$3,575
Ongoing costs	Management Fee for Other Establishment Services. Management Fees for Ongoing Services. Licence Fees. Additional Fees. Costs of harvesting and transportation. Cost of Rehabilitation Fire and Hail insurance cover requested by the Grower.

20. The Project will be conducted on 3 properties located between Casino and Grafton in NSW. The properties on which the Project will be located are Barragunda, Yaraldi and Wandali. The Project is to carry out a planting of second-generation Slash pine x Caribbean pine hybrid trees on land that is held by the Forestry Commission of New South Wales ('State Forests'). The project is for a minimum period of 25 years.

21. Growers participating in the arrangement will enter into a Forestry Right agreement with State Forests. This Agreement gives a Grower a Forestry Right from State Forests over an identifiable area of land being a Servient Tenement called a 'Forestry Right Interest' until the expiry of the Forestry Right in accordance with Item 4 of

Annexure A to the Forestry Right agreement. Each Forestry Right Interest consists of approximately 1 hectare of plantable forest. Forestry Right Interests will be offered in parcels of 50. Each parcel of 50 Forestry Right Interests is known as a 'Unit'.

22. The Grower will enter into a Forestry Management Agreement with Australian Forestry Management Pty Limited ('the Manager'). Under this agreement the Grower engages the Manager to carry out the management of their Unit. The Manager will establish and cultivate second-generation Slash pine x Caribbean pine hybrid trees on the Grower's Unit and be responsible for the provision of Forestry Services, thinning, harvesting, marketing and selling the Plantation Produce. Growers may elect, after being advised of the harvest schedule but within the period specified by the Manager, to harvest, market and sell their own Plantation Produce (clause 6.5). Where a Grower has not made an election to harvest and market their own Plantation Produce the Manager will market the Plantation Produce on behalf of the Grower (clauses 6.6 and 6.7).

23. Under the Information Memorandum, Arrow Capital Pty Limited ('Arrow Capital') proposes to offer a maximum of 38 Units. There is a minimum subscription for the Project of 10 Units. Each individual Unit will be an allotment of 50 hectares of land. The Grower's Unit will be planted with approximately 1,000 trees per hectare. Units are allocated by the Manager who shall negotiate and enter into a Forestry Right Interest Agreement with State Forests, which will be the subject of a Forestry Right Interest granted in favour of the Grower. Applications will be accepted until 28 June 2003.

24. Growers will execute a Power of Attorney enabling Arrow Capital to act on their behalf as required when they make an application for Units.

Acceptance of Applications

25. The Grower's participation in the Project commences on the date the Forestry Right agreement and the Forestry Management Agreement are executed by the Applicant or Arrow Capital under its Power of Attorney for the Grower and a Unit is allocated to the Grower. The Agreements may be executed following the acceptance of a Grower's Application for a Unit(s). The Manager will not accept a Grower's Application for a Unit(s) unless the Applicant has paid the full amount of Application Moneys, as specified in the Information Memorandum, upon application for Unit(s) and minimum subscription for the Project is reached.

Forestry Right

26. The Forestry Right is entered into between State Forests as the Transferor and the Grower. The particulars of the Forestry Right are set out in Annexure A to the agreement and incorporate the covenants set out in Annexure B to the agreement. The agreement commences on the date of the Transfer and will continue for a term of 35 years unless terminated earlier pursuant to the provisions of Annexure B (clause 9 of Annexure B).

27. Growers participating in the Project are granted an interest in the Land by State Forests. The interest in the Land is granted in the form of a Unit comprising of parcels of 50 Forestry Right Interests. Growers may use their Unit(s) for the purpose of conducting a long term business of establishing, maintaining, managing and harvesting a crop of Trees. All the Trees and the Plantation Produce from the Grower's Unit(s) will be the property of the Grower (clause 4 of Annexure B).

28. Under the terms of the Forestry Right, among other things, the Grower must:

- use all reasonable endeavours to comply with all legislation, regulations, licences and codes of forestry for logging practice relevant to the Plantation;
- use its reasonable endeavours to minimise any interference with State Forests' operations and activities on the Adjacent Land; and
- promptly repair any damage caused directly by them to any roads, tracks or fences.

29. In return, amongst other things, the Grower has the right to conduct a commercial forestry project on the Unit(s) and have full and free access to the Plantation on the Forestry Interest Land during the term of the Agreement.

Forestry Management Agreement

30. The Forestry Management Agreement sets out the roles and obligations of the parties to the agreement. It is entered into between the Manager and the Grower. Under the agreement the Grower appoints the Manager to provide the Forestry Services to the Grower.

31. The agreement commences on the date of execution of the Forestry Management Agreement. The Agreement is terminated pursuant to the provisions of the agreement or, upon the Final Harvest of the entire Plantation together with the completion of the Rehabilitation of the Plantation Land and the Marketing and sale of all Plantation Produce. The Agreement will not be terminated later than

35 years after the Commencement Date. Growers may assign their interest only in certain circumstances as set out in clause 15 of the Forestry Management Agreement.

32. The Forestry Management Agreement provides that each Grower appoints the Manager to perform services under the agreement. The services to be performed are specified in Schedule 1 to the Agreement. The Forestry Services to be provided by the Manager include Initial Management Services, Other Establishment Services, Replanting Services and Ongoing Forestry Services. The Manager will supervise and manage all forestry services to be carried out on the Unit(s) on behalf of the Grower including, but not limited to, the provision of the following:

- (i) Initial Establishment Services:
 - ripping and mounding cultivation;
 - control of competing vegetation;
 - control of pests, weeds and animals;
 - obtaining suitable seedlings/trees, planting trees, including seedling supply and fertilising in accordance with silviculture practice; and
 - general administration services.
- (ii) Other Establishment Services:
 - manage and maintain the Grower's Unit(s);
 - follow up pest, weed and animal control;
 - monitoring for impacts on tree health and growth, and associated reasonable preventative or ameliorative action;
 - preparation of a report on the silvicultural status in respect to the Grower's Unit(s);
 - quality control and audit; and
 - general administration services.
- (iii) Replanting Services:
 - replanting of failed areas of the Grower's Unit(s) to meet minimum stocking requirements of approximately 850 stems per hectare.
- (iv) Ongoing Forestry Services:
 - manage and maintain the Grower's Unit(s) in accordance with good silvicultural practices;

- follow up pest, weed and animal control assessment, report and recommendations (but not the control activity itself);
- monitoring for impacts on tree health and growth, and associated reasonable preventative or ameliorative action;
- basic maintenance of roads, fences, firebreaks and gates;
- basic fire suppression;
- assistance to the Grower to secure markets for Plantation Produce;
- harvest planning, supervision and management;
- preparation of reports on the silvicultural status in respect to the Grower's Unit(s); and
- general administration services.

Plantation Establishment

33. The date of execution of the Forestry Right agreement and the Forestry Management Agreement will determine the period of provision of the Initial Establishment Services to which the Management Fee for Initial Establishment Services relates.

34. The Initial Establishment Services are to be performed during the following periods:

- general administration services are to be performed prior to 30 June 2003; and
- all other services that fall within the definition of Initial Establishment Services are to be performed within 12 months of the date the Grower commences to participate in the Project.

35. The Other Establishment Services will be performed during the year ended 30 June 2004. Replanting Services will only be performed once during the first two years after the Grower commences to participate in the Project. The cost of Replanting Services will be borne by the Manager. After the year ended 30 June 2004, the Manager will provide the Ongoing Forestry Services over the term of the Project.

36. The Manager will not undertake any work on behalf of a Grower on a Unit prior to the time that a Grower commences participation in the Project upon execution of the Forestry Right agreement and the Forestry Management Agreement.

Harvesting

37. At all times the Grower has full right, title and interest in the Trees, Timber and Plantation Produce from the Grower's Unit(s) and the right to have the Plantation Produce sold for their benefit (clause 6). Unless the Grower elects to harvest and market their own Plantation Produce, the Manager will arrange the marketing and sale of the Plantation Produce.

38. Harvesting and marketing of some of the Trees is to be carried out at approximately 12 years and 19 years after the Grower commences participation in the Project. The balance of the Trees will be harvested no earlier than 24 years from the date of commencement of the Management Agreement. The Manager will notify the Grower when in its opinion the Planted Land is ready for any Thinning or Final Harvest.

39. The Growers' proportional share of the costs incidental to Harvesting and transportation associated with the Plantation Produce will be paid from the gross proceeds of sale to the Manager (clause 6.2). The Manager may set off any outstanding fees due and payable by the Grower under the terms of the Forestry Management Agreement from the net proceeds of sale to be paid to the Grower (clauses 6.8 and 9.7). The Manager may also set off any other costs for which the Grower is liable under the Forestry Right agreement, including the relevant Grower's Licence Fee and Rehabilitation. The balance of the net proceeds from sale will be distributed to the Non-Electing Growers on a proportionate basis.

40. If a Grower elects to harvest, market and sell their Plantation Produce, any amounts due and payable under the Forestry Management Agreement must be paid to the Manager at the time the Grower notifies the Manager of their election (clause 6.5).

Fees

41. Under the terms of the Forestry Right agreement and the Forestry Management Agreement a Grower will make payments per Unit as described below.

42. A **Management Fee** of \$178,750 per Unit is payable on Application. The Management Fee is consideration for the Manager agreeing to carry out the Initial Establishment Services. The Management Fee for Initial Establishment Services contains an amount of \$100.00 per Unit for the provision of general administration services that are to be performed prior to 30 June 2003. The remainder of the fee relates to the provision of Initial

Establishment Services to be performed within 12 months of the date of the Forestry Management Agreement.

43. A **Management Fee** of \$ 33,550 per Unit is payable by 25 June 2004 for the Other Establishment Services to be provided in the year ended 30 June 2004.

44. **Management Fees** are to be paid annually in arrears on 25 June for the term of the Forestry Management Agreement for the provision of Ongoing Services. The first Management Fee of \$7,975 is payable by 25 June 2005 for the provision of Ongoing Services for the year ending 30 June 2005. In subsequent years the Management Fee will be adjusted on 1 July in each year for the term of the Forestry Management Agreement, with the first review date being 1 July 2005 in respect to the year ending 30 June 2006. The Management Fee will be adjusted by reference to movements in the Consumer Price Index ('CPI') for the December quarter immediately before the Relevant Review Date published by the Commonwealth Statistician and, in the case of the first Review Date the CPI for the December quarter 2001 and in every other case, the CPI for the Review Date immediately preceding the Relevant Review Date.

45. **Licence Fees** are to be paid annually in arrears on 25 June for the term of the Forestry Right agreement to State Forests. The first Licence Fee payment of \$5,995 is due on 25 June 2004 in respect of the year ending 30 June 2004. In subsequent years the Licence Fee will be adjusted on 1 July in each year with the first Review date being 1 July 2004 in respect to the year ending 30 June 2005. The Licence Fees will be adjusted by reference to movements in the CPI for the December quarter immediately before the Relevant Review Date published by the Commonwealth Statistician and, in the case of the first Review Date the CPI for the December quarter 2001 and in every other case, the CPI for the Review Date immediately preceding the Relevant Review Date.

Other Fees

46. Where Additional Services are to be provided by the Manager, the Manager must provide a quote to the Grower. Upon receipt of payment of the **Additional Fee** the Manager must perform the works and services quoted for.

47. Growers who elect to have the Manager harvest, market and sell their Plantation Produce are required to pay the costs of **harvesting and transportation** associated with the Plantation Produce.

48. Growers are obliged to pay for the cost of **Rehabilitation** of their Unit(s) after harvest. Rehabilitation costs are estimated to be between \$15,000 and \$25,000 per Unit.

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49. The Grower may request that the Manager take out fire and hail **insurance** over the Grower's Unit(s), at the Growers expense.

Finance

50. Growers can fund their involvement in the Project by borrowing from NM Rothschild & Sons (Australia) Limited (a lender associated with the Manager).

51. Those Growers may enter into the following finance arrangement:

- the Grower may borrow \$140,000 per Unit applied for;
- the term of the loan may for a period to 2 June 2004;
- interest will accrue daily on the Principal Sum at the fixed Specified Rate of 13% over the term of the loan;
- if interest is paid when due the Lender will accept interest calculated at the fixed rate of 11% over the term of the loan; and
- the principal and interest are payable on the Repayment Date, being 2 June 2004.

52. 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;

- NM Rothschild & Sons (Australia) Limited become involved in the provision of finance to Growers for the Project, other than the finance arrangement described at paragraph 51; or
- entities associated with the Project other than NM Rothschild & Sons (Australia) Limited are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

53. This Ruling applies only to Growers who are accepted to participate in the Project on or before 28 June 2003 and who have executed a Forestry Management Agreement and a Forestry Right agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

54. This Ruling does not apply to those Growers who make an election under the Forestry Management Agreement to harvest and market the Plantation Produce from their Unit(s).

Minimum subscription

55. 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. Under the terms of the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 10 interests is achieved.

The Simplified Tax System ('STS')

Division 328

56. 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

57. 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

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

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

Deductions for Management Fees, Licence Fees and Interest

Section 8-1

60. A Grower who is not an 'STS taxpayer' may claim tax deductions under section 8-1 of the ITAA 1997, for the following revenue expenses for each Unit held.

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Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee for Initial Establishment Services - 'seasonally dependent agronomic activities'	8-1	\$178,650 See Notes (i) & (ii) (below)		
Management Fee for Initial Establishment Services – Administration Services	8-1	\$100 - See Notes (i) & (iii) (below)		
Management Fee for Other Establishment Services	8-1		\$33,550 - See Notes (i) & (iii) (below)	
Management Fee for Ongoing Services	8-1			\$7,975 - See Notes (i) & (iii) (below)
Licence Fee	8-1		\$5,995 - See Notes (i) & (iii) (below)	\$5,995 (indexed) - See Notes (i) & (iii) (below)
Interest	8-1	As incurred See Note (iv) (below)	As incurred See Note (iv) (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 1 at paragraph 145).
- (ii) The Management Fee for Initial Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 106 to 110) and is deductible in the income year in which it is incurred.
- (iii) The Management Fee for administration services, Management Fee for Other Establishment Services,

Management Fees for Ongoing Services and the Licence Fees shown in the Forestry Management Agreement and the Forestry Right 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 (see paragraphs 98 to 110). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 104 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.

- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than NM Rothschild & Sons (Australia) Limited, 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 NM Rothschild & Sons (Australia) Limited, should read the discussion of the prepayment rules in paragraphs 120 to 126 (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.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and Section 328-105

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

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

Deductions for Management Fees, Licence Fees and Interest**Sections 8-1 and 328-105**

63. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses for each Unit held. However, if for any reason, an amount shown in the Tables below 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 Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee for Initial Establishment Services - 'seasonally dependent agronomic activities'	8-1 & 328-105	\$178,650 - See Notes (v) & (vi) (below)		
Management Fee for Administration Services	8-1 & 328-105	\$100 - See Notes (i) & (iii) (below)		
Management Fee for Other Establishment Services	8-1 & 328-105		\$33,550 - See Notes (i) & (iii) (below)	
Management Fee for Ongoing Services	8-1 & 328-105			\$7,975 - See Notes (v) & (vii) (below)
Licence Fee	8-1 & 328-105		\$5,995 - See Notes (v) & (vii) (below)	\$5,995 (indexed) - See Notes (v) & (vii) (below)
Interest	8-1 & 328-105	As incurred See Note (viii) (below)	As incurred 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 145.
- (vi) The Management Fee for Initial Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 106 to 110) and is deductible in the income year in which it is paid.
- (vii) Where a Grower who is an 'STS taxpayer', pays the Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees in the relevant income years shown in the Forestry Management Agreement and the Forestry Right 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 income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 98 to 110). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 104, 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 NM Rothschild & Sons (Australia) Limited, 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 NM Rothschild & Sons (Australia) Limited, should read the discussion of the prepayment rules in paragraph paragraphs 120 to 126 (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.

Tax outcomes that apply to all Growers**Division 35 – Deferral of losses from non-commercial business activities****Section 35-55 – Commissioner’s discretion**

64. For a Grower who is an individual and who enters the Project during the year ended 30 June 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 2026 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 130 in the Explanations part of this ruling, below);
- 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)).

66. 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.

67. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1) 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

68. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the 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 98 to 119);
- 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

Corporations Act 2001

69. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in section 761G of the *Corporations Act 2001*.

70. Offers to wholesale clients do not require a prospectus or product disclosure statement.

71. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the persons satisfies one of the following tests:

- the ‘product value test’ (paragraph 761G(7)(a);
- the ‘individual wealth test’ (paragraph 761G(7)(c);
- the ‘professional investor test’ (paragraph 761G(7)(d).

72. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘product value test’ where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000.

73. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘individual wealth test’ where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

74. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

Is the Grower carrying on a business?

75. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Northern Softwood Project 2003 must amount to the carrying on of a business of primary production.

76. Where there is a business, or a future business, the gross proceeds from the sale of the Plantation Produce 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.

77. For schemes such as that of the Northern Softwood Project 2003, 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; (1984) 15 ATR 932.

78. 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 Trees and sell the Grower's Plantation Produce from their Unit(s);
- 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

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- the weight and influence of general indicators point to the carrying on of a business.

79. In this Project, each Grower enters into a Forestry Right agreement and a Forestry Management Agreement.

80. Under the Forestry Right agreement and the Forestry Management Agreement each individual Grower will have rights over a specific and identifiable area of a minimum of 50 hectares of land. The Forestry Right agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Forestry Right agreement the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Forestry Right agreement allows the Manager to come onto the land to carry out its obligations under the Forestry Management Agreement.

81. Under the Forestry Management Agreement Australian Forestry Management Pty Limited is engaged by the Grower to establish and maintain a Plantation on the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Plantation on the Grower's behalf.

82. The Manager is also engaged to harvest Trees and Timber and sell the Plantation Produce grown on the Grower's Unit(s), on the Grower's behalf.

83. 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.

84. 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 Plantation 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.

85. The pooling of Plantation Produce from trees grown on the Grower's Unit(s) with the Plantation Produce of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled Plantation Produce will reflect the proportion of the trees contributed from their Unit(s).

86. The Manager'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 Unit is relatively small, it is of a size and scale to allow it to be commercially viable. (See Taxation Ruling IT 360).

87. The Grower's degree of control over the Manager as evidenced by the Forestry Management Agreement is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Unit(s) and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

88. 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 Growers' afforestation activities in the Northern Softwood Project 2003 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

89. 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.

90. 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 Management Fees and Licence Fees

Section 8-1

91. Consideration of whether the Management Fee for Initial Establishment Services, Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer 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.

92. Management Fee for Initial Establishment Services, Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees 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 Plantation Produce from the Growers Unit(s)) 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 fees is identifiable from the arrangement. The fees appear to be reasonable. There is no capital component of the Management Fee for Initial Establishment Services, Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

93. Under the Forestry Right agreement and the Forestry Management Agreement neither the Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services nor the Licence Fees 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.

94. However, where a Grower **chooses** to prepay the Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services or the Licence Fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 98 to 110) 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

95. In the absence of any application of the prepayment provisions, the timing of deductions for the Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

96. If the Grower is not an 'STS taxpayer', Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services or the Licence Fees are deductible in the year in which they are incurred.

97. If the Grower is an 'STS taxpayer' the Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services or the Licence Fees 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.

Prepayment provisions

Sections 82KZL to 82KZMG

98. 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.

99. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG are relevant. Subject to section 82KZMG, if 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 them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

100. Other than expenditure deductible under section 82KZMG, if 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)).

101. 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;
- 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.

102. 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 NM Rothschild & Sons (Australia) Limited. 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.

103. 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.

104. 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.

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

105. 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.

Section 82KZMG

106. Under section 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

107. Subsection 82KZMG(2) requires that the expenditure is:

- incurred on or after 2 October 2001 and on or before 30 June 2006; and
- the eligible service period must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year; and
- for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

108. To satisfy subsection 82KZMG(3) the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling; and
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give

directions does not equate to day to day control for the purposes of this requirement); and

- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

109. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling.

110. Subsection 82KZMG(5) defines the 'establishment period' to commence at the time that the first 'seasonally dependent agronomic activity' is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

111. Under the Forestry Management Agreement, a Grower incurs a Management Fee for Initial Establishment Services consisting of expenditure of \$178,650 per Unit, for 'seasonally dependent agronomic activities'.

112. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2003 for the Management Fee for Initial Establishment Services incurred under the Forestry Management Agreement for 'seasonally dependent agronomic activities'.

113. The Forestry Right agreement and the Forestry Management Agreement also require that a Grower incurs a Management Fee of \$100 per Unit for the performance of administration services prior to 30 June 2003, a Management Fee of \$33,550 per Unit for the performance of Other Establishment Services to be provided by the Manager in the year ended 30 June 2004, Management Fees for Ongoing Services for the performance of Management Services during the term of the Project and Licence Fees to lease land during the term of the Project.

114. The Management Fee for administration services, Management Fee for Other Establishment Services, Management Fees for Ongoing Services and the Licence Fees incurred under the Forestry Right agreement and the Forestry Management Agreement are not prepaid. These fees are charged for providing administration services, Other Establishment Services, Ongoing Services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred.

115. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the Management Fees and Licence Fees.

116. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

Growers who choose to pay Management Fees or Licence Fees for a period in excess of that required by the Project's agreements

117. Although not required under the Forestry Right agreement and the Forestry Management Agreement, a Grower participating in the Project may choose to prepay Fees/Interest for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 115 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

119. 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.

Interest deductibility

Section 8-1

(i) Growers who use NM Rothschild & Sons (Australia) Limited as the finance provider

120. Some Growers may finance their participation in the Project through a loan facility with NM Rothschild & Sons (Australia) Limited. Whether the resulting interest costs are deductible under

section 8-1 depends on the same reasoning as that applied to the deductibility of Management and Licence Fees.

121. The Interest incurred for the years ended 30 June 2003 and 30 June 2004 will be in respect of a loan to finance the Grower's business operations - the cultivation and growing of trees and the lease (or licence) 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.

122. As with the Management Fees and the Licence Fees, in the absence of any application of the prepayment provisions (see paragraphs 98 to 110), the timing of deductions for Interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

124. 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 NM Rothschild & Sons (Australia) Limited as the finance provider

125. 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 NM Rothschild & Sons (Australia) Limited 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.

126. 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 98 to 110).

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

127. 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.

128. 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.

129. 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.

130. 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.

131. 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).

132. 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 in the Project of 1 Unit during the year ended 30 June 2003 may find that their activity meets one of the tests in each harvest year.

133. 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.

134. 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.

135. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of 1 Unit in the Project is expected to be carrying on a business activity that will pass one of the tests, or will produce a taxation profit, for the income years ended 30 June 2016, 30 June 2023 and 30 June 2027.

136. 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 2026. The taxation profit that is projected for the income years ended 30 June 2016 and 30 June 2023 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.

137. 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 paragraph 64), in the manner described in the Arrangement (see paragraphs 14 to 52). 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.

138. 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 Arrow Capital Pty Limited; and
- independent, objective, and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by Arrow Capital Pty Limited.

Section 82KL - recouped expenditure

139. 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’.

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

141. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. Here, there may be a loan provided to the Grower by NM Rothschild & Sons (Australia) Limited (refer to paragraph 51). The loan described in the arrangement part of this ruling will be provided on a full recourse basis, and on commercial terms. Insufficient ‘additional benefits’ will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

142. 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).

143. The Northern Softwood Project 2003 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 60 and 63 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

144. 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 Plantation 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 are 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 1 - Entitlement to GST input tax credits**

145. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her afforestation 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:

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

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

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

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 \$4,000 (not \$4,400).

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 \$2,000 only, not one tenth of \$2,200).

Detailed contents list

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Commissioner of Taxation

4 December 2002

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
 - commencement of business

- fee expenses
 - horticulture
 - management fees expenses
 - primary production
 - primary production expenses
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 - product rulings
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- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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NO: T2002/012760

ISSN: 1441-1162