



PR 2002/146 - Income tax: 2003 Timbercorp Eucalypts Project - Prepayment Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *18 December 2002*



Product Ruling

Income tax: 2003 Timbercorp Eucalypts Project – Prepayment Growers

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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.

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

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 2003 Timbercorp Eucalypts Project, or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Section 25-25 (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.

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 18 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 2006. 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 specified below. This arrangement incorporates the following documents:

- Application for Product Ruling received on 23 September 2002;
- Draft prospectus for the 2003 Timbercorp Eucalypts Project, undated, ('the Prospectus') prepared for Timbercorp Securities Limited ('TSL'), ('the Responsible Entity');
- The **Constitution** of the 2003 Timbercorp Eucalypts Project, undated, received on 23 September 2002;
- Draft **Management Agreement (Prepayment Growers)** between the Grower and TSL undated, received on 23 September 2002;
- Draft Plantation Services Agreement (Prepayment Growers) between TSL and Timbercorp Forestry Pty Ltd, undated, received on 23 September 2002;
- Draft **Agreement for Sub-lease (Prepayment Growers)** between the Grower and TSL, undated, received on 4 December 2002;
- Draft **Sub-lease - Victoria (Prepayment Growers - Land Available)** between the Grower and TSL, undated, received on 23 September 2002;
- Draft **Sub-lease - West Australia (Prepayment Growers - Land Available)** between the Grower and TSL, undated, received on 23 September 2002;
- Draft **Sub-lease - South Australia (Prepayment Growers - Land Available)** between the Grower and TSL, undated, received on 23 September 2002;
- Draft **Sub-lease - Victoria (Prepayment Growers - Land Initially Unavailable)** between the Grower and TSL, undated, received on 4 December 2002;
- Draft **Sub-lease - West Australia (Prepayment Growers - Land Initially Unavailable)** between the Grower and TSL, undated, received on 4 December 2002;
- Draft **Sub-lease - South Australia (Prepayment Growers - Land Initially Unavailable)** between the Grower and TSL, undated, received on 4 December 2002;
- Draft Pro forma Head Lease and Forest Property Agreement between Timbercorp Lands Pty Ltd ('the Owner'), and TSL, undated, received on 23 September 2002;

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- Draft Custody Agreement between TSL and Permanent Trustee Company Limited ('the Custodian'), received on 23 September 2002;
- Draft Finance Package which includes the **Loan Application Form** and Loan Explanation and Loan Terms, undated, received on 23 September 2002; and
- Correspondence (including e-mails from the applicant or the applicant's representative to the Tax Office), dated 24 September, 25 September 2002, 22 November 2002, 27 November 2002, 29 November 2002, 3 December 2002, 4 December 2002 and 10 December 2002.

Note: certain information received from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under the 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. The effect of the agreements may be summarised as follows.

Overview

17. This arrangement is called the 2003 Timbercorp Eucalypts Project - Prepayment Growers.

Location	Southwest Western Australia, southeast South Australia and western Victoria.
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Eucalyptus globulus</i> trees (Tasmania Blue Gum) for the purpose of producing timber for wood chipping and for manufacturing premium quality paper.
Number of hectares under cultivation	4,000 which may be increased to allow for oversubscriptions.
Number of Woodlots offered	4,000
Size of each Woodlot	Net plantable area of 1 to 1.2 hectares.

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Number of trees per hectare	Between 833 and 1,250
The term of the Project	8-12 years.
Minimum subscription for Project	None.
Minimum subscription per Grower	3 Woodlots (TSL reserves the right to accept applications for less than 3 Woodlots).
Fees payable per Woodlot on subscription	\$3,905
Financial year after application date:	<ul style="list-style-type: none"> • Rent - \$308 • Note: Maintenance fees of \$85.80 (indexed for CPI is payable annually commencing on 31 October 2004)
Other costs (all Growers)	<ul style="list-style-type: none"> • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, the prescribed proportion of the harvest, delivery and other costs; • To the extent that they have not been deducted from the purchase price payable for the sale of the Wood, a harvest supervision /management fee of 3.25% of the net proceeds payable to the Grower; • An amount equal to 1/3 of net proceeds payable to the Grower in excess of net sale proceeds per Woodlot forecast in the Prospectus less allowance for inflation and indexed; • An amount equal to 1/3 of net proceeds from the sale of the Grower's Carbon Credits; • Insurance (if Grower chooses to insure).
Other Features	Growers may be given an opportunity, between 6 and 12 months before the expiration of the Sub-lease, to participate in a second rotation.

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18. Based on the Constitution and the Prospectus that have been or will be lodged with the Australian Securities and Investments Commission, investors who apply to the offer made in the Prospectus may be accepted as follows:

- Early Growers - Growers in respect of which the Project Manager will complete the acquisition of seedlings and the preparation of the land on or before 30 June 2003 and plant eucalyptus seedlings on the Woodlots by 31 August 2003;
- Prepayment Growers - any Grower whose application is received and accepted by the Project Manager on or before 30 June 2003 in respect of which the Responsible Entity will complete the Establishment Services after 30 June 2003, but within the initial 12-month establishment period; and
- Post 30 June Growers - Growers whose application is received and accepted by the Project Manager on or after 1 July 2003 and before the expiry of the Prospectus.

19. It should be noted that Growers accepted in the year ending 30 June 2003 will only be accepted as either Early Growers or Prepayment Growers. TSL may decide to set a 'Cut-off Time' which is a date before 30 June 2003, by which participants who are accepted on or before the Cut-off Time will be accepted as Early Growers while those participants accepted after the Cut-off Time but on or before 30 June 2003 will be accepted as Prepayment Growers. **This Ruling only applies in respect of Prepayment Growers.**

20. The 2003 Timbercorp Eucalypts Project will be registered as a managed investment scheme under the *Corporations Act 2001*. Prepayment Growers entering into the Project will sub-lease land from TSL, in Victoria, South Australia or in Western Australia. The sub-lease is for a term expiring on the earlier of 30 June 2017 or the completion of harvesting.

21. If plantation land is not available at the time applications are accepted, Prepayment Growers will, severally, enter into an Agreement for Sub-lease. Prepayment Growers will be required to make payment for the first year Annual Rent once the land has been secured by TSL, and the Sub-lease Agreement executed. The minimum area of land leased by each Grower is 3 identifiable allotments of land of between 1 and 1.2 hectares which are referred to as Woodlots, although TSL reserves the right to accept applications for less than 3 Woodlots.

22. There are 4,000 Woodlots on offer with an option to accept oversubscriptions. TSL, as the Responsible Entity and Project Manager will ensure that, for applicants who apply and are accepted

into the Project after the Cut-off Time and on or before 30 June 2003, TSL will complete the Establishment Services within the initial 12 month period after acceptance of their applications.

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

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

25. Under this Joint Venture:

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

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

Management Agreement

General provisions

27. Growers contract with TSL to establish and maintain the plantation until maturity and to harvest and sell the wood on their behalf.

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

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

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

31. The Management Agreement provides that a Grower commissions and engages TSL as an independent contractor (and not as an agent) to carry out the Establishment Services (including the Planting Services) and the Plantation Services during the Term in accordance with the Management Plan. Growers are not entitled to assign the Management Agreement except in certain circumstances. The Management Agreement specifies the Establishment Services that will be carried out by TSL and these are as follows:

- ripping and mounding Woodlots as necessary;
- otherwise preparing Woodlots for planting as necessary;
- procuring and tending to sufficient seedlings of eucalyptus Trees of appropriate size as is reasonably required to complete the Planting Services;
- applying fertilisers, herbicides or pesticides to Woodlots as necessary;
- spraying Woodlots as necessary; and
- the Planting Services, which is defined to mean the planting of eucalyptus seedlings on relevant Woodlots and the application of fertiliser, herbicides or pesticides to the seedlings or relevant Woodlots in conjunction with the planting, but does not include the planting of eucalyptus seedlings to replace existing seedlings that do not survive.

32. The Establishment Services will be provided during the Establishment Period, which is the period commencing the date of acceptance of the application for Woodlots and ending 12 months thereafter.

Plantation Services

33. TSL will also provide Plantation Services to Growers which will commence from 1 July 2004. The Plantation Services are as follows:

- cultivating, tending and managing the Trees;
- infilling or replanting any part of the Trees which fail to achieve the survival objective set out in the Management Plan;
- insuring the maintenance of appropriate firebreaks on the relevant Woodlots;

- ensuring that all reasonable steps are taken to control any plants and animals on or about the relevant Woodlots in accordance with all relevant laws;
- repairing promptly all damage done to any roads, tracks or fences on the relevant Woodlots or on Neighbouring Land resulting from the actions of the Responsible Entity or its contractors or their respective employees;
- embarking on such operations as may be required primarily and principally to prevent or combat land degradation in relation to the relevant Woodlots;
- taking all reasonable steps to avoid interfering with the activities carried out on any Neighbouring Land by the owner or occupier of that land;
- securing the entryways to the relevant Woodlots in order to prevent trespassers entering the relevant Woodlots and to take such other security measure as it considers appropriate; and
- keeping the specified insurance policies current with a reputable insurer.

Sub-lease Agreements

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

Agreement for Sub-lease

35. Where plantation land is not available at the time a Prepayment Grower's application is accepted, the Grower and TSL will enter into this agreement. This agreement is conditional upon the Grower entering into the Management Agreement.

36. Under this agreement, TSL acknowledges that it has identified land that meets the land selection criteria adopted by the Timbercorp group for plantation. TSL further acknowledges that it will enter into a Sub-lease as attorney for the Grower in sufficient time for TSL to perform the Establishment Services within the Establishment Period as provided in the Management Agreement.

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37. This agreement further provides that before the execution of the Sub-lease (Land Initially Unavailable), TSL must be satisfied that the following conditions are met:

- the Head Lease is valid and subsisting;
- TSL is entitled under the Head Lease to grant the Sub-lease to the Grower;
- any consents which may be required to the granting of the Sub-lease (other than those which are conditional to the subsequent granting of the Sub-lease) have been obtained; and
- the Woodlots that are the subject of the Sub-lease are not subject to any encumbrance or restriction which detrimentally affects the Grower's interest, other than those already disclosed in the Prospectus.

Fees

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

- \$3,905 in respect of the Establishment Services to be performed during the Establishment Period, payable on application ('initial management fee');
- Annual Rent;
 - where plantation land is secured on or before 31 October 2003, \$308 and is therefore payable on 31 October 2003 for the period ending 30 June 2004. Thereafter, on each subsequent 31 October, the Annual Rent is \$308 per Woodlot. This fee will be adjusted each year to the greater of the previous year's rent or the indexed amount and will be payable in respect of each year ending 30 June (i.e., quarterly in arrears and three quarterly in advance);
 - where plantation land is secured after 31 October 2003 and before 30 June 2004, \$308 it is payable on the Commencement Date of the Sub-lease Agreement, for the period ending 30 June 2004. Thereafter, on each subsequent 31 October, the Annual Rent is \$308 per Woodlot. This fee will be adjusted each year to the greater of the previous year's rent or the

indexed amount and will be payable in respect of each year ending 30 June (i.e., quarterly in arrears and three quarterly in advance); and

- commencing 31 October 2004, \$85.80 for Plantation Services, payable on 31 October of each year in respect of the period 1 July to the next succeeding 30 June (i.e., quarterly in arrears and three quarterly in advance). The fee will be indexed each year with the first indexation due on 31 October 2004 ('maintenance fee').

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

Application and Power of Attorney Form

40. Growers are required to complete this Form to apply for Woodlots being offered in the Project. Under this Form, \$3,960 application money is payable by an Early Grower on application. Because the amount payable on application by Prepayment Growers is \$3,905, the Prospectus provides that \$55 will be refunded to Prepayment Growers within one month after their application is accepted.

Planting and Harvesting

41. It is contemplated in the Prospectus that the Establishment Services and Planting Services will be provided and the Woodlots will be fully established within the initial 12 months following acceptance of applications.

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

43. The harvest period for applicants who are accepted as Prepayment Growers is between 30 September 2012 and 30 September 2016. TSL will be responsible for arranging the marketing, harvesting and sale of the wood, with the Grower kept informed of the details, including proposed purchase price and harvesting and delivery costs. One of the assumptions used in the financial forecasts shown in the Prospectus is that Trees from the

Woodlots of each class of Growers will be harvested approximately 10 years after planting.

Finance

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

45. The provision of finance involves full recourse loans where the Financier will pursue legal action against defaulting borrowers. Growers entering into the following finance arrangement are covered by this Ruling;

- the Financier will lend generally up to 80% of the Grower's application amount;
- the Financier will provide Growers who subscribe to the minimum subscription amount of three Woodlots with a minimum Loan Amount of \$5,000;
- the Grower will pay a loan application fee of \$250 to accompany the Application Form;
- the Grower may choose from 4 Loan Terms ranging from 3 years, 4 years, 5 years and 7 years. The interest rate will depend on the term of the loan which is fixed for the Loan Term;
- the loan is repayable by equal monthly instalments of principle and interest;
- in the event that any amount is overdue, the Financier may charge interest at the Default Rate;
- the Grower is entitled to repay the whole or any part of the Total Amount Owing without penalty for early repayment;
- the Grower will assign and transfer over to the Financier by way of fixed charge all its rights, title and interest at any time in the Project including Woodlots and the Project Agreements; and
- the Grower must maintain fire, wind and storm insurance over the Woodlots on a full replacement basis.

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

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

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

Ruling

Application of this Ruling

47. This Ruling applies only to Growers who are accepted to participate in the Project in the year ended 30 June 2003 after the Cut-off Time but on or before 30 June 2003 where the Grower has executed a Management Agreement and a Sub-lease Agreement or an Agreement for Sub-lease after the Cut-off Time but on or before 30 June 2003. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

48. 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.

The Simplified Tax System ('STS')

Division 328

49. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on

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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

50. 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

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

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

Deductions for Initial Management Fee, Maintenance Fees, Annual Rent, Interest and Borrowing Costs.

Section 8-1

53. A Prepayment Grower who is accepted to participate in the Project, who **is not** a Joint Venture Grower (as explained in paragraphs 24 to 26) and who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses shown in the table below.

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Initial management fee	8-1	\$3,905 See Notes (i) & (ii) (below)	nil	nil
Maintenance fee	8-1	nil	nil	\$85.80 indexed – See Notes (i) & (iii) (below)
Annual Rent	8-1	nil	\$308 – See Notes (i) & (iii) (below)	\$308 indexed – See Notes (I) & (iii) (below)
Interest	8-1	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)
Borrowing costs	25-25	Must be calculated- see note (v) below	Must be calculated- see note (v) below	Must be calculated- see note (v) below

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example at paragraph 129.
- (ii) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is incurred.
- (iii) Where a Grower who is not an ‘STS taxpayer’, pays the maintenance fee and the Annual Rent in the relevant income years shown in the Management Agreement and the Sub-lease Agreement, those fees are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must

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be determined using the formula shown in paragraph 89 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 Timbercorp Finance Pty Ltd, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 82 to 105 (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.
- (v) The loan application fee is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter.

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

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

Tax outcomes for Growers who are ‘STS taxpayers’**Assessable Income****Section 6-5 and section 328-105**

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

56. 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 Initial Management Fee, Maintenance Fees, Annual Rent, Interest and Borrowing Costs.**Section 8-1 and section 328-105**

57. A Prepayment Grower who is accepted to participate in the Project, who **is not** a Joint Venture Grower (as explained in paragraphs 24 to 26) and who is a ‘STS taxpayer’ may claim tax deductions for the following revenue expenses shown in the table below.

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Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Initial management fee	8-1 328-105	Must be calculated- See Notes (vi), (vii) & (viii) (below)	nil	nil
Maintenance fee	8-1 328-105	nil	nil	\$85.80 indexed – See Notes (viii) & (ix) (below)
Annual Rent	8-1 328-105		\$308 – See Notes (viii) & (ix) (below)	\$308 indexed – See Notes (viii) & (ix) (below)
Interest	8-1 328-105	As incurred See Note (x) (below)	As incurred See Note (x) (below)	As incurred See Note (x) (below)
Borrowing costs	25-25	Must be calculated- see note (xi) below	Must be calculated- see note (xi) below	Must be calculated- see note (xi) below

Notes:

- (vi) 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). See Example at paragraph 129.
- (vii) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is incurred.
- (viii) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an ‘STS taxpayer’ then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

- (ix) Where a Grower who is an 'STS taxpayer', pays the maintenance fees and the Annual Rent in the relevant income years shown in the Management Agreement and the Sub-lease Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 82 to 105). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 89, 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.
- (x) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 82 to 105 (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.
- (xi) The loan application fee is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter.

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

- (i) the **first** Joint Venture Grower referred to in paragraph 25 may claim deductions for amounts incurred and paid for the establishment fee, borrowing costs and for any interest incurred and paid on funds borrowed from Timbercorp Finance Pty Ltd; and

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

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner’s discretion

59. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 and/or 30 June 2004 and who will engage the Project Manager to arrange for the harvesting of trees and the marketing of timber, 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 2013 for a Prepayment Grower 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.

60. 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 116 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)).

61. 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.

62. 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

63. 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 82 to 105);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

64. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the 2003 Timbercorp Eucalypts Project – Prepayment Growers must amount to the carrying on of a business of primary production.

65. Where there is a business, or a future business, the gross proceeds from the sale of the wood 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.

66. For schemes such as that of the 2003 Timbercorp Eucalypts Project – Prepayment Growers, 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) 16 ATR 55.

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

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

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

69. Under the Sub-lease Agreement each individual Grower will have rights over individual Woodlots, each being a specific and identifiable area of 1 to 1.2 hectares of land. The Sub-lease Agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the sub-lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The sub-lease allows the Project Manager to come onto the land to carry out its obligations under the Management Agreement.

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

71. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Woodlot.

72. 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.

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

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

75. The Project 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 Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

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

77. 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 2003 Timbercorp Eucalypts Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

78. 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.

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

Deductibility of Initial Management Fee, Maintenance Fees and Annual Rent.

Section 8-1

80. Consideration of whether the initial management fees, maintenance fees and lease 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;

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- 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.

81. The initial management fees, maintenance fees and Annual Rent associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of wood produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the initial management fee and maintenance fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMG

82. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deduction 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 (eg. 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.

83. 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

84. 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)).

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

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

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

87. 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

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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.

88. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure.

89. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

90. 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

91. 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).

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

- incurred on or after 2 October 2001 and on or before 30 June 2006;
- 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.

93. 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 Project Manager manages, arranges or promotes the agreement, or an associate of the Project Manager, manages, arranges or promotes similar agreements.

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

95. 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

96. Under the Management Agreement, a Prepayment Grower incurs a Year 1 initial management fee consisting of expenditure of \$3905 for 'seasonally dependent agronomic activities'.

97. The 'seasonally dependent agronomic activities' that will be carried out by the Project Manager on the Grower's behalf during the 'establishment period' are ripping and mounding the Woodlots as necessary, procuring and tending to sufficient seedlings of eucalyptus trees of appropriate size, applying fertiliser, herbicides or pesticides, spraying and planting services. During the term of the Project, the eucalyptus trees will be tended by the Project Manager for the Growers and are specifically grown for felling in the harvest year.

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

99. The Management Agreement also requires that a Grower incurs a maintenance fee of \$85.80 per year during years 3 to 11 for the performance of maintenance services during the term of the Project. Under the Sub-lease Agreement a Grower incurs Annual Rent of \$308 to sub-lease land during the term of the Project.

100. The maintenance fee incurred under the Management Agreement in years 3 to 11 and the Annual Rent incurred under the Sub-lease Agreement are not prepaid. These fees are charged for providing maintenance services and for the lease of the land to a Grower until 30 June of the year in which the fees are incurred.

101. 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 maintenance fees in years 3 to 11 and the Annual Rent.

102. 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 fees for a period in excess of that required by the Project's agreements

103. Although not required under either the Management Agreement, the Sub-lease Agreement, or the Loan Agreement with Timbercorp Finance Pty Ltd (see below), 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 102 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

104. For these Growers, the amount and timing of deductions for any relevant prepaid maintenance fees, prepaid Annual Rent, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

105. 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 Timbercorp Pty Ltd as the finance provider

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

107. The interest incurred for the year ended 30 June 2003 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing trees and the lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

108. As with the maintenance fees and the Annual Rent, in the absence of any application of the prepayment provisions (see paragraphs 82 to 105), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

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

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

111. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

112. 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 82 to 105).

Deferral of losses from non-commercial business activities

Division 35

113. 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

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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.

114. 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.

115. 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.

116. 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.

117. 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).

118. 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

Prepayment Grower who acquires the minimum allocation of three Woodlots in the Project is unlikely to have the activity pass one of the tests until the income year ended 30 June 2014. A Prepayment Grower who acquires one Woodlot is also expected to be carrying on a business activity that will produce taxation profit in the income years ended 30 June 2014.

119. 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.

120. 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.

121. Information provided with this Product Ruling indicates that a Prepayment Grower who acquires the minimum investment of three Woodlots in the Project is expected to be carrying on a business activity that will pass one of the tests in the income years ended 30 June 2014. A Prepayment Grower who acquires one Woodlot is also expected to be carrying on a business activity that will produce taxation profit in the income years ended 30 June 2014.

122. The Commissioner will decide for a Prepayment 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 2013.

123. 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 59), in the manner described in the Arrangement (see paragraphs 14 to 46). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1), 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) will apply in such changed circumstances.

124. 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; 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 the Responsible Entity.

Losses and Outgoings incurred under certain Tax Avoidance Schemes

Section 82KL - recouped expenditure

125. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Schemes to Reduce Income Tax

Part IVA - general tax avoidance provisions

126. 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).

127. The 2003 Timbercorp Eucalypts Project – Prepayment Growers 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 53 to 57 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.

128. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the wood produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be

considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example - Entitlement to GST input tax credits

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

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

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

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

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

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

Hence her outgoing for the power upgrade is effectively \$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

18 December 2002

Previous draft:

Not previously released in draft form

- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 82KZMG

Related Rulings/Determinations:

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

- ITAA 1936 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
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- ITAA 1936 82KZMG(5)

Subject references:

- advance deductions and expenses for certain forestry expenditure
- carrying on a business
- commencement of business
- fee expenses
- forestry agreement
- interest expenses
- management fees
- producing assessable income
- product ruling
- public rulings
- seasonally dependent agronomic activity
- taxation administration
- tax avoidance
- tax benefits under tax avoidance
- schemes
- tax shelters
- tax shelters project

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