



PR 2002/20 - Income tax: 1994 Timbercorp Eucalypts Project

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Product Ruling

Income tax: 1994 Timbercorp Eucalypts Project

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Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Participants must form their own view about the commercial and financial viability of the product. This involves a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

Participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 1994 Timbercorp Eucalypts Project, or simply as 'the Project'.

Tax laws

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

Changes in the Law

3. 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.

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

Note to promoters and advisers

5. 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

6. The class of persons to whom this Ruling applies is those persons who were accepted into the Project between 22 April 1994 and 21 October 1994. 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'.

7. The class of persons to whom this Ruling applies does not include persons who have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project.

Qualifications

8. 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

10. This Ruling applies prospectively from 20 February 2002 for Growers who, between 22 April 1994 and 21 October 1994, entered into the specified arrangement that is set out below. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

11. 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

12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, even following its withdrawal, in respect of the tax laws ruled upon, to all persons within

the specified class who entered into the specified arrangement that is set out below between 22 April 1994 and 21 October 1994. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

13. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 31 July 2001;
- Prospectus for the 1994 Timbercorp Eucalypts Project lodged with the Australian Securities Commission on 22 April 1994;
- **Agency Deed** between the Grower, Timbercorp Eucalypts Limited (now, Timbercorp Limited) ('Timbercorp') and Permanent Trustee Company Limited ('the Representative');
- **Third Supplemental Deed** between the Grower, Timbercorp Eucalypts Limited and Permanent Trustee Company Limited;
- **Sub-lease** between the Grower, W.A. Chip & Pulp Co. Pty Ltd ('the Landholder') and Permanent Trustee Company Limited;
- **Management Agreement** between the Grower, Timbercorp Eucalypts Limited and Permanent Trustee Company Limited;
- **Loan Agreement** between Timbercorp Finance Pty Ltd and the Grower; and
- Correspondence and attachments from the Tax Adviser dated 1 November 2001 and 3 December 2001.

Note: certain information received has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

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

15. 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

16. The arrangement is the 1994 Timbercorp Eucalypts Project. The salient features of the Project are shown in the table below.

Location	South west Western Australia
Type of business	Commercial growing of <i>Eucalyptus globulus</i> (Tasmanian Bluegum) for harvest and sale to the highest bidder, expecting the Trees to be processed into woodchips for manufacture into premium quality paper
Minimum subscription	20 Woodlots
Minimum Woodlots per participation	3 Woodlots
Size of each Woodlot	One hectare
Term of project	8 to 10 years.
Initial cost per Woodlot	\$3,300 - for plantation preparation and establishment \$160 - for the first year's rent
Other costs	Fire insurance (optional)

17. The project land is located in south west of Western Australia. The Landholder has in existence leases on the properties that have been sub-leased to Growers. Subscription to the Project was offered through the 1994 prospectus. The Project was registered with the Australian Securities Commission on 22 April 1994.

18. Growers participating in the Project entered into a Sub-lease and a Management Agreement. Growers leased a parcel of land with a net plantable area of approximately one hectare called a 'Woodlot' from the Landholder. A Grower must have applied for a minimum of

3 Woodlots. A total of 20 Woodlots must have been applied for before any Woodlot was allocated under the prospectus.

Sub-lease Agreement

19. Growers participating in the Project were granted an interest in land by the Landholder in the form of a Sub-lease to use and occupy their Woodlots for the purpose of conducting their afforestation business. The Sub-lease gives the Grower a lease over identifiable areas of land (each 1 hectare, called a 'Woodlot') until the final distribution of the sale proceeds is made to the Grower or until the Project is terminated. Growers are not entitled to assign the Sub-lease Agreement except in certain circumstances.

20. Under the Sub-lease, the Grower agrees, among other things, to use the Woodlots solely for growing, tending and harvesting plantations of eucalyptus trees.

Management Agreement

21. The Management Agreement provides that a Grower appoints Timbercorp Eucalypts Ltd as the Project Manager to perform services under the agreement. Growers are not entitled to assign the Management Agreement except in certain circumstances.

22. Under this agreement, Timbercorp must, amongst other things:

- maintain the Woodlot according to sound silvicultural and environmental practices;
- acquire the seeds or seedlings for planting;
- establish, tend and maintain the Trees;
- harvest the wood between 15 April 2003 and 10 years from the Sub-Lease Commencement Date ('First Harvest');
- ensure the construction and maintenance of firebreaks;
- take reasonable steps to control any plants or animals on or about the Woodlot;
- keep a public insurance policy; and
- make all reasonable endeavours to obtain all required State and Commonwealth government approvals, licences and permission for establishment of the Trees.

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

Timbercorp Agency Deed

24. The Project was established under an Agency Deed. The Trustee, Permanent Trustee Company Limited, acts as the representative of the Growers subject to the terms and conditions contained in the Deed.

25. The Agency Deed dated 1 May 1992 was amended by the first supplemental deed dated 29 March 1993, the second supplemental deed dated 3 May 1993, the third supplemental deed dated 21 April 1994, the fourth supplemental deed dated 11 April 1995, the fifth supplemental deed dated 2 April 1996, the sixth supplemental deed dated 3 March 1997 and the seventh supplemental deed dated 12 March 1998. There were no other supplemental deeds executed between 29 March 1993 and 12 March 1998.

Fees

26. An annual rent of \$160 on a per Woodlot basis (indexed to the CPI from 30 June 1994) is payable under the Sub-lease.

27. The fees payable under the Management Agreement on a per Woodlot basis are as follows:

- plantation preparation and establishment fee of \$3,300;
- annual plantation maintenance fee of \$60 (indexed to CPI from 30 June 1994); and
- charges upon harvest as follows:
 - (a) harvest supervision/management fee of 5% of stumpage price;
 - (b) harvest and delivery costs; and
 - (c) Grower's Representative fee of 0.5% of stumpage price less harvest supervision fee.

28. Under the financial hardship provision of the Management Agreement, Growers can apply to have their remaining annual rent and maintenance fees from year 6 paid by Timbercorp in return for 5% of their sale proceeds for each year in which the costs are paid by Timbercorp.

29. The fees identified above are payable in accordance with the Schedule attached to the respective Sub-lease and Management Agreement. For Growers who were accepted on or before 30 June 1994, the initial annual rent and plantation preparation and establishment fee were payable on or before 30 June 1994 and the

subsequent annual rent and plantation maintenance fee were payable on 15 June each year.

Planting and Harvest

30. Up to 1,000 Woodlots were offered for subscription under the prospectus with the option to accept oversubscription. The Woodlots were planted within 13 months of subscription. Timbercorp maintains the trees in accordance with good silvicultural practice, provides ongoing reports to the Growers on the progress of the plantations and Timbercorp 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. The harvest will take place between 15 April 2003 and 10 years from the Sub-Lease Commencement Date or as otherwise agreed in writing between the Grower and Timbercorp.

31. Growers have executed a power of attorney enabling the Representative to act on their behalf in entering the Chiplog Agreement with Timbercorp and the Purchaser for the purchase of the wood from the First Harvest.

32. Each Grower is entitled to a proportionate share of the proceeds less their proportionate share of Harvesting and Delivery costs, including the Harvest supervision fee. Timbercorp Eucalypts Ltd is entitled to one third of any proceeds in excess of those shown in the prospectus. The projected proceeds and returns if harvests will be undertaken 10 years after planting are shown in the prospectus.

Finance

33. Growers may have funded their participation in the Project themselves, borrowed from Timbercorp Finance Pty Ltd (a wholly owned subsidiary of Timbercorp Eucalypts Ltd) or borrowed from an independent lender.

34. The finance offered by Timbercorp Finance Pty Ltd was made on a full recourse basis and borrowers are or were required to pay the loan by equal monthly instalments of principal and interest. The interest rate varied depending on the term of the loan. The terms of the loan provide that security was given over the Grower's interest in the Project including the Woodlots allocated to that Grower.

35. 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

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

Section 35-55 – Commissioner's discretion

36. For a Grower who is an individual and who entered the Project between 22 April 1994 and 21 October 1994 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 has decided that for the income years ended 30 June 2001 to 30 June 2004 the rule in section 35-10 does not apply to this business activity. This is provided that the Project has been, and continues during the remainder of the term of the Project, to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 13 to 35 of this Product Ruling.

37. 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 43 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;
- the 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); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

38. Where, the exception in subsection 35-10(4) applies, or 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.

39. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Explanations

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

40. 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.

41. 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.

42. 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.

43. 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 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.

44. 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 vehicle) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

45. A Grower who was accepted into and who has participated in the Project since 22 April 1994 is carrying on a business activity that is subject to these provisions.

46. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired the minimum allocation of 3 interest(s) in the Project is unlikely to have their business activity pass one of the tests until the income year ended 30 June 2005.

47. 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.

48. 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:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) 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.

49. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of 3 interest(s) in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2005. The Commissioner has decided for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2004. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2004.

50. The applicant has stated that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 13 to 35 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 36), in the manner described in the arrangement, this Ruling may be affected. Specifically, the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 8). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

51. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report of the independent forester; and
- independent, objective, and generally available information relating to the afforestation industry.

Detailed contents list

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

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 97/16; TD 93/34; TR 98/22

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

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

ATO references:

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