

PR 2002/52 - Income tax: Environinvest Eucalypt Project No. 5

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 May 2002*



Product Ruling

Income tax: Environinvest Eucalypt Project No. 5

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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 Environinvest Eucalypt Project No 5, 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.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

11. This Ruling applies prospectively from 1 May 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling for the Environinvest Eucalypt Project No 5, dated 2 October 2001, including Schedules 2, 3A, 3B, 3C, 3D, 4, 5, 6, 7, 8, 9, 10 & 11;

- Draft prospectus for the Environinvest Eucalypt Project No 5 (schedule 2 to the Application);
- Final prospectus for the Environinvest Eucalypt Project No 5 dated 18 October 2001 (supplied on 24 October 2001);
- Loan application form (Schedule 3A to the Application);
- **Sample Loan agreements relating to a Principal Only Loan, an Interest Only Loan, and a Principal and Interest Loan** (Schedules 3A, 3B and 3C to the Application);
- Constitution of Environinvest Ltd (the Responsible Entity) (Schedule 4 to the Application);
- **Constitution of the Environinvest Agricultural Fund** (Schedule 7 to the Application);
- **Lease between Environinvest Ltd as Landlord, and the Grower** (Annexure A1 to the Constitution of the Environinvest Agricultural Fund) (final version provided 17 April 2002);
- **Management Agreement between Environinvest Ltd as Manager, and the Grower** (Annexure A2 to the Constitution of the Environinvest Agricultural Fund) (final version provided 17 April 2002);
- Compliance Plan for the Environinvest Eucalypt Project No 5 (Schedule 8 to the Application);
- Forester's Report dated 24 August 2001 (Schedule 11 to the Application);
- Draft Product Ruling supplied on 16 November 2001 (referred to in accompanying correspondence as Schedule 12 to the Application);
- Correspondence (including e-mails) from the Tax Office to the applicant or the applicant's representative, dated 26 October 2001, 16 November 2001, 22 January 2002, 20 February 2002, 22 February 2002, 25 February 2002, 7 March 2002, 11 April 2002, 15 April 2002, 16 April 2002, 17 April 2002;
- Correspondence (including e-mails) from the applicant or the applicant's representative to the Tax Office, dated 24 October 2001, 15 November 2001, 23 November 2001, 10 January 2002, 14 January 2002, 20 February 2002, 26 February 2002, 1 March 2002,

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27 March 2002, 3 April 2002, 10 April 2002,
11 April 2002, 12 April 2002, 15 April 2002,
16 April 2002, 17 April 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 these agreements may be summarised as follows.

Overview

17. The arrangement is called the Environinvest Eucalypt Project No 5.

Location	The land will be located in Western Victoria, the Green Triangle area of Victoria and South Australia, and in South Eastern New South Wales.
Type of business each participant will carry on	Commercial growing of <i>Eucalyptus globulus</i> (Tasmanian Bluegums) for the purpose of producing timber for woodchipping.
Number of hectares offered	Not specified, but limited to land owned or leased by Environinvest Ltd and offered for lease to Growers during currency of the prospectus dated 18 October 2001.
Size of each Allotment	0.5 hectares.
Minimum allocation per Grower	2 Allotments (i.e., 1 hectare).
Number of trees per hectare	A minimum of 1000 trees per hectare will be planted and 900 trees per hectare are guaranteed at the end of the second Subsequent Year.
Projected yield per hectare	Subject to seasonal and climatic variations and other stated risks associated with forestry operations, an average yield of 250 cubic metres is projected.

Term of the Project	Between 8 and 12 years
Initial cost per Allotment	\$2,832.50 (consisting of \$2,502.50 Establishment Fee, \$220 Planting Fee and \$110 Lease Rental).
Initial cost per hectare	\$5,665 (consisting of \$5,005 Establishment Fee, \$440 Planting Fee and \$220 Lease Rental).
Ongoing costs per Allotment	\$38.50 Annual Maintenance Fee in Year 2 (thereafter the preceding year's fee indexed by the All Group Consumer Price Index)
Ongoing costs per hectare	\$77 Annual Maintenance Fee in Year 2 (thereafter the preceding year's fee indexed by the All Group Consumer Price Index)
Other costs	<ul style="list-style-type: none"> • \$100 in the Application Year for Growers using Environinvest Ltd as finance provider. • Costs and outgoings related to the clearfell of the trees will be deducted from the gross Sale Proceeds. • A 5.5% Harvesting Fee will be deducted from the net Sale Proceeds before tax.

18. The Project consists of an arrangement between Growers and Environinvest Ltd ('Environinvest') for the growing of *Eucalyptus globulus* (Tasmanian Bluegums) to produce timber for woodchipping. The Project will be established for between 8 years and 12 years. There is no minimum subscription for the Project. Growers will be provided with annual reports containing information about their Allotments and by arrangement, Growers can visit their Allotments (page 3 prospectus).

19. Environinvest holds, or will acquire sufficient suitable land for the purposes of the Project. The criteria for suitable land are shown on page 16 of the prospectus. The land is, or will be located in Western Victoria, the Green Triangle area of Victoria and South Australia, and, subject to successful negotiations, South Eastern New South Wales. Environinvest has provided the Tax Office with details of land it currently holds in its land bank. Environinvest may acquire additional land for the purpose of this Project. Additional land that is suitable for the growing of Tasmanian Bluegums will form part of this arrangement where that land is either purchased or leased before the expiry of the current prospectus on 18 November 2002.

Power of attorney

20. To be accepted to participate in the Project Growers must grant Environinvest an irrevocable power of attorney to complete the Lease

and the Management Agreement and carry out other management activities related to the Project.

21. Other than an Event of Default (as defined in the Lease and the Management Agreement), the power of attorney does not authorise Environinvest to:

- sell, transfer or dispose of any part or all of the Grower's interest in the Land;
- to re-finance any loans taken out by the Grower in respect of the Allotments or the Project Documents without the Grower's consent; or
- in any way increase the Grower's liability or impose any additional burden on the Grower without the Grower's consent.

Lease and Schedule

22. The parties to the Lease are Environinvest (the Landlord) and the Grower named and described in item 3 of the Schedule. Under the terms of the Lease, the Grower is granted a proprietary interest over an identifiable interest in an area of Land consisting of at least two Allotments, each of 0.5ha, for the purpose of carrying on a business of establishing, maintaining and harvesting of Tasmanian Bluegums (the 'Trees').

23. The Lease sets out the purpose for which the Grower may use the land (clause 3), the Grower's covenants (clause 4), the Landlord's covenants (clause 5) and a process for dispute resolution (clause 9). Other than an Event of Default, the Lease will be terminated automatically the day after the clear fell and removal of the Trees from the Allotments (clause 8). Certain miscellaneous provisions are set out in clause 10 including the circumstances under which either party may assign the Lease.

24. The Schedule sets out the Grower's identifiable interest in the Land (Item 4), the details of the Land on which the Grower's Allotments are located (Item 5) and the Lease Rental (Item 6). The Lease Rental is discussed below under the heading 'Fees'. The Landlord will take all reasonable steps to collect the Lease Rental should it not be paid as and when required.

Management Agreement and Schedule

25. The parties to the Lease are Environinvest (the Manager) and the Grower named and described in item 3 of the Schedule. From the Commencement Date the Grower appoints the Manager to carry out, on Land that the Grower has leased from the Landlord, the

Establishment Services, Planting Services, and Maintenance Services and, as the Grower's agent, to carry out the Harvesting Services (clause 2). Each of the Services referred to in this paragraph is defined in the Management Agreement.

26. Under subclause 3.1 the Manager will commence the Establishment Services as soon as is reasonably practicable after the Commencement Date and use all reasonable endeavours to complete those Services:

- within 12 months of the payment of the Establishment Fee; and
- by 30 June of the First Subsequent Year

27. Under subclause 3.2 the Manager will commence the Planting Services as soon as is reasonably practicable after the conclusion of the Establishment Services and shall complete the Planting Services:

- within 12 months of the payment of the Planting Fee; and
- by 30 June of the First Subsequent Year.

28. To assist the Grower determine the tax deductions relating to these Services, the Manager will provide a Notice to the Grower stating the extent and value of the Establishment Services and Planting Services completed in the relevant year (subclause 3.3).

29. Where the Establishment Services and the Planting Services have been completed by or during the First Subsequent Year, the Manager will carry out the Maintenance Services in the First Subsequent Year and each Subsequent Year. Otherwise the Maintenance Services will be completed in each Subsequent Year (subclause 3.4).

30. The Manager will provide the Harvesting Services in the Harvest Year. Having regard to the growth of the Trees, market conditions and the Grower's wishes, the Manager has an absolute and unfettered discretion to determine the Harvest Year. The Manager estimates that the Harvest Year will be in the eighth to twelfth Subsequent Year (subclause 3.5).

31. The Management Fees are set out in clause 4 by reference to the Schedule. The Schedule sets out the Establishment Fee (item 4), the Planting Fee (item 5), the Maintenance Fee (item 6), and the Harvesting Fee (item 7). These fees are discussed below under the heading 'Fees'. The Manager will take all reasonable steps to collect the Establishment Fee, Planting Fee, Maintenance Fee and Harvesting Fee should it not be paid as and when required.

32. Clause 5 sets out the Grower's Obligations under the Management Agreement and clause 6 sets out the Manager's

Obligations. Under subclause 6.1 the Manager agrees to use all reasonable endeavours to carry out its duties and obligations:

- in accordance with established, modern, scientific and good management and husbandry methods and practices;
- with due skill, expertise, diligence and vigour;
- using good and sufficient materials and services; and
- so as to comply with all applicable laws, regulations, orders and rules including the Corporations Legislation.

33. Clause 7 provides for the establishment of one or more Grower's Accounts. Among other things, the Manager, as the Grower's agent will use the Grower's Account(s) to hold the Sale Proceeds and other moneys pending distribution to the Growers.

34. Other matters dealt with by the Management Agreement include insurance and proceeds of insurance (clause 8), rights and other matters relating to Carbon Credits (clause 9), default and termination (clause 12), dispute resolution (clause 13) and certain miscellaneous matters (clause 14). Of particular relevance, subclause 12.4 provides that, other than where an Event of Default occurs, the Management Agreement will be terminated automatically the day after the clear fell and removal of the Trees from the Allotments and subclause 14.7 sets out the circumstances under which either party may assign the Management Agreement.

Constitution of the Environinvest Agricultural Fund (the 'Fund')

35. The Constitution sets out how the Fund operates pursuant to the requirements of the *Corporations Act 2001*.

36. Among other things, the Constitution sets out in detail the following:

- The appointment of Environinvest as the Responsible Entity of the Project (clause 3);
- The opening of bank accounts for the purposes of an Application Fund to hold Application Moneys and the Proceeds Fund to hold money generated from the Project other than Application Moneys (clause 5);
- The division of the Project into Interests (with certain rights and obligations) and the holding of those Interests by Growers (clause 6), the consideration payable to acquire an Interest (clause 7), and the status, execution and cancellation of Project documents relating to an Interest (clause 8);

- The payment of Application Moneys by cheque, the placing of Application Moneys into the Application Fund, the duties of the Responsible Entity in relation to Application Moneys, and the transfer of Application Moneys from the Application Fund (clauses 10 and 11);
- The issuing of numbered Certificates (clause 12), the holding of Scheme Property on trust for the Growers (clause 13), and the maintenance of a register setting out details of the Growers (clause 17);
- The payment of proceeds into the Proceeds Fund (clause 20), deductions that may be made from the Proceeds (clause 21), and distributions to the Growers from the Proceeds Fund (clause 22);
- A process for dealing with complaints (clause 23), the assignment of a Grower's Interest (clause 25), the retirement and removal of the Responsible Entity (clause 27) and winding up the Project (clause 34).

Fees

37. Under the terms of the Management Agreement and the Lease, (which are annexed to the Constitution), a Grower will pay the following fees per Allotment:

- An Establishment Fee of \$2832.50 (payable once only, upon Application);
- A Planting Fee of \$220 (payable once only, upon Application);
- Lease Rental of \$110 payable upon Application. Thereafter, for the term of the Project, the amount payable in the preceding year (indexed in accordance with the All Group Consumer Price Index), is payable in arrears on 30 June of each Subsequent Year;
- An Annual Maintenance Fee of \$38.50, payable in arrears on 30 June of the First Subsequent Year (where Maintenance Services are provided in that year) or, otherwise, in the Subsequent Year following the First Subsequent Year. Thereafter, for the term of the Project, the amount payable in the preceding year (indexed in accordance with the All Group Consumer Price Index), is payable in arrears on 30 June of each Subsequent Year;

- For Growers who borrow from Environinvest, a once-only Loan Establishment Fee of \$100, payable upon Application;
- A Harvest Fee of 5.5% of the net Sale Proceeds payable is in the Harvest Year.

Finance

38. Growers can fund all or part of the Establishment Fee, Planting Fee, the Maintenance Fee and the Lease Rental by borrowing from Environinvest, acting in the capacity of finance provider, or by borrowing from a third party financier

39. Environinvest will offer three finance options to Growers. Loans that differ materially in its terms and conditions from those described below are outside the scope of this Product Ruling:

- (i) A **Principal Only Loan** with the following features:
 - the Grower must provide Environinvest with a deposit of not less than 10% of the Application Fee;
 - the principal is repayable in 12 equal monthly instalments, in arrears;
 - the monthly instalments are payable on or before the end of each calendar month commencing in the first calendar month after the loan moneys are drawn down;
 - a loan establishment fee of no more than \$100 is payable; and
 - at least, minimum security by mortgage over the Lease and the Trees.
- (ii) A **Principal and Interest Loan** with the following features:
 - the Grower must provide Environinvest with a deposit of not less than 10% of the Application Fee;
 - the term of the loan may be up to 7 years;
 - from the Commencement Date the principal and interest is repayable in equal monthly instalments, in arrears;
 - the rate of interest rate is fixed over the term of the loan;

- the fixed rate of interest per annum will be not more than 4% above the base rate per annum that is charged from time to time by the National Australia Bank Ltd or its successor on unsecured overdraft accounts;
- the monthly instalments are payable on or before the end of each calendar month commencing in the first calendar month after the loan moneys are drawn down;
- a loan establishment fee of no more than \$100 is payable; and
- at least, minimum security by mortgage over the Lease and the Trees.

(iii) An **Interest Only Loan** with the following features:

- the Grower must provide Environinvest with a deposit of not less than 10% of the Application Fee;
- the rate of interest rate is fixed over the term of the loan;
- the fixed rate of interest per annum will be not more than 4% above the base rate per annum that is charged from time to time by the National Australia Bank Ltd or its successor on unsecured overdraft accounts;
- interest is payable annually in advance in equal amounts, beginning on the Commencement Date;
- the principal is payable on the Final Repayment Date as set out in Item 10 of the Schedule;
- a loan establishment fee of no more than \$100 is payable; and
- at least a minimum security by mortgage over the Lease and the Trees.

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

Ruling

Application of this Ruling

41. This Ruling applies only to Growers who are accepted to participate in the Project on or before 18 November 2002 and who have executed a Management Agreement and a Lease on or before that date. The Ruling will not apply to any Grower who is allocated less than two Allotments in the Project.

42. 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 Grower’s participation in the Project must constitute the carrying on of a business of primary production.

The Simplified Tax System (‘STS’)

Division 328

43. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an ‘STS taxpayer’. To be an ‘STS taxpayer’ a Grower:

- must be eligible to be an ‘STS taxpayer’; and
- must have elected to be an ‘STS taxpayer’.

Qualification

44. 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**

45. 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.

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

PR 2002/52**Deductions for the Establishment Fee, the Planting Fee, Maintenance Fees, Lease Rentals, and Interest****Section 8-1**

47. A Grower who is accepted to participate in the Project on or before 30 June 2002 and is not an 'STS taxpayer' may claim, on a per Allotment basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Establishment Fee	8-1	\$2,502.50 See Notes (i) & (ii) (below)		
Planting Fee	8-1	\$220 See Notes (i) & (ii) (below)		
Maintenance fees	8-1		\$38.50 – See Notes (i) & (iii) (below)	\$38.50 – See Notes (i) & (iii) (below)
Lease Rental	8-1	\$110 – See Notes (i) & (iii) (below)	\$110 – See Notes (i) & (iii) (below)	\$110– See Notes (i) & (v) (below)
Interest (Interest only loan from Environinvest)	8-1	Must be calculated See Note (iv) (below)	Must be calculated See Note (iv) (below)	Must be calculated See Note (iv) (below)
Interest (Principal and interest loan from Environinvest)	8-1	As incurred See Note (v) & (vi) (below)	As incurred See Note (v) & (vi) (below)	As incurred See Note (v) & (vi) (below)
Loan Establishment Fee	25-25	\$100 See Note (vii) (below)		

48. A Grower who is accepted to participate in the Project on or after 1 July 2002 and on or before 18 November 2002 and is not an 'STS taxpayer' may claim, on a per Allotment basis, tax deductions for the following properly incurred revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Establishment Fee	8-1	\$2,502.50 See Notes (i) & (ii) (below)		
Planting Fee	8-1	\$220 See Notes (i) & (ii) (below)		
Maintenance fees	8-1		\$38.50 – See Notes (i) & (iii) (below)	\$38.50 – See Notes (i) & (iii) (below)
Lease Rental	8-1	\$110 – See Notes (i) & (iii) (below)	\$110 – See Notes (i) & (iii) (below)	\$110– See Notes (i) & (v) (below)
Interest (Interest only loan from Environinvest)	8-1	Must be calculated See Note (iv) (below)	Must be calculated See Note (iv) (below)	Must be calculated See Note (iv) (below)
Interest (Principal and interest loan from Environinvest)	8-1	As incurred See Note (v) & (vi) (below)	As incurred See Note (v) & (vi) (below)	As incurred See Note (v) & (vi) (below)
Loan Establishment Fee	25-25	\$100 See Note (vii) (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 124;
- (ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred. 'Seasonally dependent agronomic activities' are explained below at paragraphs 85 to 89;

- (iii) Where a Grower who is not an ‘STS taxpayer’, pays the Maintenance Fee and the Lease Rental in the relevant income years shown in the Management Agreement and the Lease, 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 maintenance services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 77 to 84). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 83 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) Growers who enter into an **Interest Only Loan** with Environinvest incur interest annually in advance, beginning from the Commencement date. Such interest is **NOT** deductible in full in the year in which it is incurred, unless the amount of the interest is ‘excluded expenditure’ (see Note (iii) above). Where the amount of interest is not ‘excluded expenditure’ the deduction for the interest paid in advance each year must be determined using the formula in subsection 82KZMF(1) (see paragraph 83). Environinvest will inform Growers of the Commencement Date to allow Growers to determine the number of days in the ‘eligible service period’ in the first expenditure year (i.e., the Application Year). This figure is necessary to calculate the deduction allowable for the interest incurred. (See Example 2 at paragraph 125);
- (v) Growers who enter into a **Principal and Interest Loan** with Environinvest incur interest monthly, in arrears. Such interest is deductible when incurred;
- (vi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Environinvest is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Environinvest, should read the discussion of the prepayment rules in paragraphs 77 to 84 (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;

- (vii) Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or are to be used during that income year for income producing purposes. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

49. 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.

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

PR 2002/52**Deductions for the Establishment Fee, the Planting Fee, Maintenance Fees, Lease Rentals, and Interest****Section 8-1 and section 328-105**

51. A Grower who is accepted to participate in the Project on or before 30 June 2002 may claim, on a per Allotment basis, tax deductions for the following properly incurred and paid revenue expenses. If an amount of expenditure is not fully paid in the year shown in the table below, it is only deductible to the extent that it is paid:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Establishment Fee	8-1	\$2,502.50 See Notes (viii) & (ix) (below)		
Planting Fee	8-1	\$220 See Notes (viii) & (ix) (below)		
Maintenance fees	8-1		\$38.50 – See Notes (viii) & (x) (below)	\$38.50 – See Notes (viii) & (x) (below)
Lease Rental	8-1	\$110 – See Notes (viii) & (x) (below)	\$110 – See Notes (viii) & (x) (below)	\$110 – See Notes (viii) & (x) (below)
Interest (Interest only loan from Environinvest)	8-1	Must be calculated See Notes (xi) (below)	Must be calculated See Notes (xi) (below)	Must be calculated See Notes (xi) (below)
Interest (Principal and interest loan from Environinvest)	8-1	As incurred See Note (xii) & (xiii) (below)	As incurred See Note (xii) & (xiii) (below)	As incurred See Note (xii) & (xiii) (below)
Loan Establishment Fee	25-25	\$100 See Note (xiv) (below)		

52. A Grower who is accepted to participate in the Project on or after 1 July 2002 and on or before 18 November 2002 may claim, on a per Allotment basis, tax deductions for the following properly incurred and paid revenue expenses. If an amount of expenditure is not fully paid in the year shown in the table below, it is only deductible to the extent that it is paid:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Establishment Fee	8-1	\$2,502.50 See Notes (viii) & (ix) (below)		
Planting Fee	8-1	\$220 See Notes (viii) & (ix) (below)		
Maintenance fees	8-1		\$38.50 – See Notes (viii) & (x) (below)	\$38.50 – See Notes (viii) & (x) (below)
Lease Rental	8-1	\$110 – See Notes (viii) & (x) (below)	\$110 – See Notes (viii) & (x) (below)	\$110 – See Notes (viii) & (x) (below)
Interest (Interest only loan from Environinvest)	8-1	Must be calculated See Notes (xi) (below)	Must be calculated See Notes (xi) (below)	Must be calculated See Notes (xi) (below)
Interest (Principal and interest loan from Environinvest)	8-1	As incurred See Note (xii) & (xiii) (below)	As incurred See Note (xii) & (xiii) (below)	As incurred See Note (xii) & (xiii) (below)
Loan Establishment Fee	25-25	\$100 See Note (xiv) (below)		

Notes:

- (viii) 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 124;
- (ix) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is

incurred. 'Seasonally dependent agronomic activities' are explained below at paragraphs 85 to 89;

- (x) Where a Grower who is an 'STS taxpayer', pays the Maintenance Fees and the Lease Rental in the relevant income years shown in the Management Agreement and the Lease, 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 maintenance 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 77 to 84). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 83, 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;
- (xi) Growers who enter into an **Interest Only Loan** with Environinvest incur interest annually in advance, beginning from the Commencement date. Such interest is **NOT** deductible in full in the year in which it is incurred and paid, unless the amount of the interest is 'excluded expenditure' (see Note (ix) above). Where the amount of interest is not 'excluded expenditure' the deduction for the interest paid in advance each year must be determined using the formula in subsection 82KZMF(1) (see paragraph 83). Environinvest will inform Growers of the Commencement Date to allow Growers to determine the number of days in the 'eligible service period' in the first expenditure year (i.e., the Application Year). This figure is necessary to calculate the deduction allowable for the interest incurred. (See Example 2 at paragraph 125);
- (xii) Growers who enter into a **Principal and Interest Loan** with Environinvest incur interest monthly, in arrears. For STS taxpayers such interest is deductible when incurred and paid;
- (xiii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Environinvest is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with

Environinvest, should read the discussion of the prepayment rules in paragraphs 77 to 84 (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;

- (xiv) Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or are to be used during that income year for income producing purposes. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner's discretion

53. For a Grower who is an individual and who enters the Project during the income year ended 30 June 2002 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 2002 to 30 June 2012 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.

54. For a Grower who is an individual and who enters the Project on or after 1 July 2002 and on or before the 18 November 2002 (i.e., during the income year ended 30 June 2003) the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2013 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.

55. 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 111 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)).

56. 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.

57. 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.

Section 82KL and Part IVA

58. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Lease the following provisions of the ITAA 1936 have application as indicated:

- 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?

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

60. 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.

61. For schemes such as that of the Environinvest Eucalypt Project No 5, 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.

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

- the Grower has an identifiable interest by 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 a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

63. In this Project, each Grower enters into a Management Agreement and a Lease with Environinvest.

64. Under the Lease each individual Grower will have rights over a specific and identifiable area of, at least, one hectare of land. The Lease provides the Grower with an ongoing interest in the specific Trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The lease allows the Environinvest come onto to the land to carry out its obligations under the Management Agreement.

65. Under the Management Agreement Environinvest is engaged by the Grower to establish and maintain Tasmanian Bluegums Allotment on the Grower's identifiable area of land during the term of the Project. Environinvest has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Allotments on the Grower's behalf.

66. Environinvest is also engaged to fell the Trees and sell, as the Grower's common law agent, the wood produce grown on the Grower's Allotment.

67. 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.

68. 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.

69. The pooling of wood produce from the Trees grown on the Grower's Allotments 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 Allotments.

70. Environinvest'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 an Allotment is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

71. The Grower's degree of control over Environinvest as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Allotments 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.

72. 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 Environinvest Eucalypt Project No 5 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

73. 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.

74. 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 the Establishment Fee, the Planting Fee, and the Lease Rental

Section 8-1

75. Consideration of whether the initial Establishment Fee, Planting Fee, and Lease Rental are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer’s assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

76. The Establishment Fee, Planting Fee and Lease Rental 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 these 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

77. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain

expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

78. 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

79. 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)).

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

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

promotes similar agreements for other taxpayers.

81. 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 whom, in order to participate in the Project may borrow funds from a financier other than Environinvest. 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.

82. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

83. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

84. 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

85. 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).

86. 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.

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

- it must be an agreement for planting and tending trees for felling;
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and
- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

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

89. 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

90. Under the Management Agreement, per Allotment, a Grower incurs an Establishment Fee of \$2,502.50 and a Planting Fee of \$220 in the Application Year. Both fees are expenditure for 'seasonally dependent agronomic activities'.

91. The ‘seasonally dependent agronomic activities that will be carried out by Environinvest on the Grower’s behalf during the ‘establishment period’ are ploughing, ripping and other subsurface works, soil improvement, fertilising, and acquisition, supply and planting of the Grower’s Trees. During the term of the Project, the Trees will be tended by Environinvest for the Growers and are specifically grown for felling in the Harvest Year.

92. As the requirements of section 82KZMG have been met a Grower who is not an ‘STS taxpayer’ can, therefore, claim an immediate deduction for the Establishment Fee and the Planting Fee in the income year in which the fee is incurred. A Grower who is an ‘STS taxpayer’ can claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid.

93. The Management Agreement also requires that a Grower incur a Maintenance Fee of \$38.50 per Allotment per year from either, the First Subsequent Year or, the Subsequent Year after the First Subsequent Year. The Maintenance Fee is for the performance of the Maintenance Services during the term of the Project. Under the Lease a Grower incurs annual Lease Rental of \$110 per allotment to lease land during the term of the Project.

94. The Maintenance Fee incurred under the Management Agreement during these years and the Lease Rentals incurred under the Lease 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.

95. 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 and the Lease Rental.

96. A Grower who is not an ‘STS taxpayer’ can, therefore, claim an immediate deduction for the Maintenance Fee and the Lease Rental in the income year in which the fee is incurred. A Grower who is an ‘STS taxpayer’ can claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid.

Growers who choose to pay fees for a period in excess of that required by the Project’s agreements

97. Although not required under the Management Agreement, the Lease, or the Principal and Interest Loan Agreement (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 95 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

99. However, as noted above, prepaid amounts 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 Environinvest as the finance provider

100. Some Growers may finance their participation in the Project through a loan facility with Environinvest. 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.

101. The interest incurred will be in respect of a loan to finance the Grower's business operations - the cultivation and growing the 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.

102. As with the Establishment Fee, the Planting Fee, the Maintenance Fees and the Lease Rentals, in the absence of any application of the prepayment provisions (see paragraphs 77 to 84), the timing of deductions for interest incurred under the **Principal and Interest Loan** will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

104. 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.

105. However, Growers who enter into an **Interest Only Loan** pay interest annually in advance. Subject to the 'excluded expenditure' exception (see above), deductions for these Growers will be determined using the formula shown in paragraph 83. However, as stated above, for Growers who are 'STS taxpayers', the deduction

calculated using this formula is only deductible to the extent to which it is paid.

(ii) Growers who DO NOT use Environinvest as the finance provider

106. 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 Environinvest 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.

107. 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 77 to 84).

Deferral of losses from non-commercial business activities

Division 35

108. 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.

109. 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.

110. 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.

111. 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.

112. 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).

113. A Grower who is accepted to participate in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of two Allotments in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2012 (for Growers accepted on or before 30 June 2002) or the income year ended 30 June 2013 (for Growers accepted on or after 1 July 2002 and on or before 18 November 2002). Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

114. 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.

115. 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.

116. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of two Allotments in the Project is expected to be carrying on a business activity that will pass one of the tests or will produce a taxation profit in the income year ended 30 June 2012 (for Growers accepted on or before 30 June 2002) or the income year ended 30 June 2013 (for Growers accepted on or after 1 July 2002 and on or before 18 November 2002).

117. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2011 (for Growers accepted on or before 30 June 2002) or the income year ended 30 June 2012 (for Growers accepted on or after 1 July 2002 and on or before 18 November 2002).

118. 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 53 or 54), in the manner described in the Arrangement (see paragraphs 14 to 40). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

119. 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;
- site visits to earlier Environinvest afforestation projects;
- independent, objective, and generally available information relating to the industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity. In particular, the Australian Forest Products March Quarter 2001 Statistics, *Forest plantations on cleared*

agricultural land in Australia (ABARE Research Report 99.11), *Global outlook for plantations* (ABARE Research Report 99.9).

Section 82KL - recouped expenditure

120. 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.

Part IVA - general tax avoidance provisions

121. 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).

122. The Environinvest Eucalypt Project No 5 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 47, 48, 51 and 52 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.

123. 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 are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example - Entitlement to GST input tax credits

124. 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:

$$1/11 \times \$4,400 = \$400.$$

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

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

$$1/11 \times \$2,200 = \$200.$$

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

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

Example 2 – Apportionment of Fees

125. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date.

The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the

other relevant agreements on his behalf. On 5 June 2002 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows:

Management fee x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2002 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,644** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2003 income year).

\$4,644 + \$85 = \$4,729 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Detailed contents list

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Related Rulings/Determinations:

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

Subject references:

- carrying on a business
 - commencement of business
 - fee expenses
 - interest expenses
 - management fee expenses
 - producing assessable income
 - product rulings
 - public rulings
 - schemes and shams
 - taxation administration
 - tax avoidance

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