



# ***PR 2002/67 - Income tax: Forest Rewards Sandalwood Project 2002 - Prepaid Woodlots***

 This cover sheet is provided for information only. It does not form part of *PR 2002/67 - Income tax: Forest Rewards Sandalwood Project 2002 - Prepaid Woodlots*

 This document has changed over time. This is a consolidated version of the ruling which was published on *22 May 2002*



## Product Ruling

### Income tax: Forest Rewards Sandalwood Project 2002 – Prepaid Woodlots

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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.

#### ***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**, **Previous Rulings**, **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**

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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 the 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**

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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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' 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 'Forest Rewards Sandalwood Project 2002 – Prepaid Woodlots', or just simply as 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Sections 82KZME - 82KZMF (ITAA 1936);
- Section 82KZMG (ITAA 1936); and
- Part IVA (ITAA 1936).

### Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the 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 those who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described 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 as set out in the description of the arrangement. In this Ruling, each of these persons, are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it. Growers that elect to harvest and market their own timber produce are also excluded from the class of persons to whom this Ruling applies (see paragraphs 44 and 49).

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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## Date of effect

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11. This Ruling applies prospectively from 22 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 the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, 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

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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 specified arrangement during the term of the Ruling. 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 persons' involvement in the arrangement.

## Previous Rulings

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14. This Ruling is based on a similar arrangement to that ruled upon in Product Ruling PR 2002/26. That Ruling also relates to the Forest Rewards Sandalwood Project 2002 but the class of persons for PR 2002/26 is restricted to Growers of Year 2002 Woodlots and Year 2003 Woodlots. PR 2002/26 continues to apply to Growers who entered into the Project on or after 20 March 2002, the date that

Ruling was made. This Ruling relates only to Growers of prepaid Woodlots (see paragraphs 22 and 23).

## **Arrangement**

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

- Applications for Product Ruling dated 3 December 2001 and 8 April 2002;
- Prospectus issued by Forest Rewards Ltd ('Responsible Entity'), dated 26 March 2002;
- Draft **Constitution** for the Forest Rewards Sandalwood Project 2002, received 15 February 2002;
- Draft **Management Agreement** between Forest Rewards Ltd (the 'Responsible Entity'), Forest Rewards Management Pty Ltd (the 'Manager') and the Grower, received 30 April 2002;
- Draft **Lease** between Forest Rewards Ltd (the 'Responsible Entity'), Forest Lands Pty Ltd (the 'Lessor') and the Grower, received 15 February 2002;
- Draft **Terms Agreement** between Forest Rewards Management Pty Ltd and the Grower, received 25 January 2002;
- Draft Compliance Plan for the Forest Rewards Sandalwood Project 2002, received 5 December 2001;
- Draft Rules for the Forest Rewards Sandalwood Project 2002, received 15 February 2002; and
- Additional correspondence from the Applicant dated 11 February 2002, 22 February 2002, 26 February 2002, 5 March 2002 and 30 April 2002.

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

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement to which this Ruling applies.

**PR 2002/67**

17. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

**Overview**

18. This salient features of the Forest Rewards Sandalwood Project 2002 are as follows:

Location	Approximately 130km north-east of Perth near Goomalling, Western Australia
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Santalum spicatum</i> (Western Australian Sandalwood) for the purpose of producing sandalwood for timber and oil extraction
Number of hectares available under this offer for cultivation	830 (1,300 Woodlots)
Minimum allocation	1 Woodlot
Size of each Woodlot	0.6 hectare
Number of Sandalwood trees per hectare	500
Expected production	6,175kg of saleable wood per hectare
The term of the Project	Approximately 19 years
Initial cost	\$5,000
Initial cost per hectare	\$8,333
Ongoing and other costs	Planting fee of \$450 payable in Year 1 Lease and Management Fees payable in arrears from harvest proceeds Optional insurance costs

19. The Project will be registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is Forest Rewards Ltd. The Project will be conducted on land known as 'Coonaring' being several parcels of land in the Avon Location contained in Certificate of Title Volume 1834 Folios 693 - 700, Volume 1355 Folios 950 - 951 and Volume 1580 Folio 284.

20. This is the second stage of a Project that commenced on the same parcel of land under a previous offer from the Responsible Entity. This offer pertains to 1,300 Woodlots of 0.6 hectares each. There is no minimum subscription for the Project. The Responsible Entity is able to accept oversubscriptions to the extent that the Lessor has suitable land available. Any additional land for the Project will only be purchased if deemed suitable by the Independent Forester for the establishment of a Sandalwood plantation.

21. Growers participating in the arrangement will enter into a Lease. Under this agreement, Growers lease an area of land called a 'Woodlot' for a term of approximately 19 years. Each Woodlot will be sown with Sandalwood seeds that will eventually be thinned to about 500 seedlings per hectare.

22. Under this offer, Growers entering the Project in the 2001/2002 income year may be accepted as Growers of either 'Year 2002 Woodlots' or 'Year 2002 Pre-paid Woodlots'. The Responsible Entity will determine under which category of Woodlot a Grower's application will be accepted having regard to its ability to schedule completion of the Initial Services by 30 June 2002. Applications may also be accepted in the 2002/2003 income year and Growers allocated either 'Year 2003 Woodlots' or 'Year 2003 Pre-paid Woodlots).

**23. This Product Ruling only applies to Growers of Year 2002 Pre-paid Woodlots or Year 2003 Pre-paid Woodlots.**

24. The Growers will also enter into a contract with the Manager for the management of their Woodlot. The Manager will be responsible for establishing and cultivating the trees. Growers may elect to harvest and sell their own timber or the Manager will do so on their behalf. Harvests are expected to take place when the Trees are aged 10, 14 and 18 years.

25. Growers may pay Subscription Money to the Manager in full or by instalments under a Terms Payment Option offered by the Manager. Growers will execute a Power of Attorney enabling the Manager to act on their behalf as required when they make an application for a Woodlot. This will include the execution of the Lease and Management Agreement, and, where the Grower elects to pay fees by instalment, a Terms Agreement.

**Constitution**

26. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Forest Rewards Ltd agrees to act as Responsible Entity and thereby manage the Project. Under the Constitution, Growers appoint Forest Rewards Ltd as sole and exclusive agent in relation to the Project. The Lease

and the Management Agreement will be executed on behalf of a Grower following them signing the Application Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

27. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into a Subscription Fund in the name of the Responsible Entity. The Subscription Money will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 3 of the Constitution).

## **Compliance plan**

28. As required by the Corporations Act a Compliance Plan has been prepared by Forest Rewards Ltd. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

## **Interest in Land**

29. Growers participating in the arrangement will enter into a Lease between the Grower, Forest Rewards Ltd in its capacity as Responsible Entity, and Forest Lands Pty Ltd as the Lessor. Growers are granted an interest in land, in the form of a lease, to use their Woodlot for the purpose of conducting their afforestation business upon terms and conditions as set out in the Lease. The lease will commence on the date Woodlots are allotted to Growers and will continue until the completion of the final harvest in approximately 19 years.

30. Each Grower must pay Rent to the Lessor for the Term of the Project in an amount specified in Item 5 of the Schedule to the Lease. However, the Rent is deferred and is payable from harvest proceeds.

## **Management Agreement**

31. The Management Agreement is between the Grower, Forest Rewards Ltd as the Responsible Entity, and Forest Rewards Management Pty Ltd as the Manager. Each Grower agrees to engage the Manager of the Project to perform services under the agreement.

32. Annexure A (Initial Services) and Annexure B (Ongoing Services) of the Agreement specify the services to be performed by the Manager.

Initial Services, are:

- supply sufficient host tree seedlings to the specifications recommended in the Management Plan;
- supply sufficient Sandalwood seed to the specifications recommended in the Management Plan;
- ensure that the Woodlots are ready for planting in accordance with the Management Plan.

Ongoing Services, include:

- tend to the Trees and Host Trees according to the principles of good forestry; including such nutrient analysis, pruning, fertilising and fumigating, as the Manager deems appropriate to promote Tree growth and yields;
- maintain and repair such roads and fences as exist on the Land and otherwise keep the Woodlots in good and substantial repair and condition;
- manage the Tree Crop in accordance with the Management Plan; and
- determine the Harvest schedule and manage each Harvest.

33. The Initial Services will be completed by the Manager within the 'Initial Period' (clause 2.2). In relation to Year 2002 Pre-paid Woodlots, agreements will be executed on 30 June 2002 and the Initial Period will extend until 30 June 2003. In relation to Year 2003 Pre-paid Woodlots the Initial Period will be a period of 12 months from the date of execution of the Management Agreement.

34. Planting Services is also a defined term in clause 1 of the Management Agreement and means the planting of the Host Trees and sowing of the Sandalwood seeds in the first financial year after the Initial Period.

### **Fees**

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

- Establishment Fee of \$5,000 payable to the Manager on Application for the provision of the Initial Services;
- Planting Fee of \$450 payable to the Manager on or before 30 June 2003 for Year 2002 Pre-Paid Woodlots and on or before 30 June 2004 for Year 2003 Pre-paid Woodlots;

- at each relevant harvest, the Grower is required to pay a Maintenance Fee to the Manager of an amount equal to 8.8% of the Grower's Share of the sales proceeds of the harvest after deducting any applicable harvest costs;
- at each relevant harvest, the Grower is required to pay Rent to the Lessor of an amount equal to 4.4% of the Grower's Share of the sales proceeds of the harvest after deducting any applicable harvest costs.

### ***Other Fees***

36. The Grower is also required to pay a Performance Fee to the Manager equal to 16.5% of any amount by which the net sales proceeds of all harvests exceeds the amount forecast per Woodlot as set out in the Prospectus (Item 5 of the Schedule).

37. The Manager will use its best endeavours, if so requested, to arrange appropriate crop insurance for the Woodlots on behalf of the Grower. The Grower is responsible for the cost of such insurance (clause 2.3).

### ***Payment of Fees***

38. Upon signing an Application Form, the Grower acknowledges that the full amount of the Subscription Money is immediately due and payable. However, under the Prospectus, the Manager is offering Terms Payment Options in respect of the Establishment Fee payable for the Initial Period and the Planting Fee payable in Year 1 of the Project (refer to paragraph 35 above). The Grower must choose one of the payment options described below. An application fee of \$50 per Woodlot applies in respect of the 1, 2 and 5 year options.

### ***Cash Option***

- \$5,000 per Woodlot payable on application;
- Planting fee of \$450 per Woodlot payable on 1 October 2002 for Year Pre-paid 2002 Woodlots and on 1 October 2003 for Year 2003 Pre-paid Woodlots.

### ***1 Year Term***

- deposit of \$250 per Woodlot payable on application;
- 12 equal monthly instalments of \$399.58 per Woodlot;

- \$455 per Woodlot payable on 1 October 2002 for Year 2002 Pre-paid Woodlots or 1 October 2003 for Year 2003 Pre-paid Woodlots.

#### *2 Year Term*

- deposit of \$250 per Woodlot payable on application;
- 24 equal monthly instalments of \$217.91 per Woodlot (including fixed interest calculated at 9% per annum);
- \$455 per Woodlot payable on 1 October 2002 for Year 2002 Pre-paid Woodlots or 1 October 2003 for Year 2003 Pre-paid Woodlots.

#### *5 Year Term*

- deposit of \$500 per Woodlot payable on application;
- 60 equal monthly instalments of \$93.82 per Woodlot (including fixed interest calculated at 9% per annum);
- \$455 per Woodlot payable on 1 October 2002 for Year 2002 Pre-paid Woodlots or 1 October 2003 for Year 2003 Pre-paid Woodlots.

39. The Manager will monitor the level of applications received under each of the Terms Payment Options and is not obliged to accept applications for terms. A limit will be imposed on the number of applications that can be accepted under each instalment option.

#### **Terms Agreement**

40. If a Grower chooses to pay under one of the instalment options, they must complete a Terms Application and Direct Debit Request. A Terms Agreement will be executed by the Manager.

41. If a Grower does not pay the required instalments under the Terms Agreement, then provided that Forest Rewards Management Pty Ltd has given the Grower 14 days written notice to remedy the situation and payment has still not been made, the balance owing under the Terms Agreement will become immediately due and payable. In addition Forest Rewards Management Ltd may take legal proceedings to recover the amount, resume all rights and interest which the Grower has in their Woodlot(s), or do anything which an owner of the Woodlot(s) is entitled to do (clause 5.2 of the Terms Agreement).

## **Planting**

42. Under the Management Agreement the Grower agrees to purchase seedlings from the Manager to enable cultivation of Trees. During the first financial year after the Initial Period the Manager will be responsible for planting the Host Trees and sowing Sandalwood seeds on the Woodlot. A sufficient number of trees will be planted which would reasonably be expected to meet the projected timber production. The Manager will conduct a survival count within 12 months of planting the Host Trees and sowing the Sandalwood seeds respectively and replant or resow as necessary. The Manager will then maintain the trees in accordance with good silvicultural practice.

## **Harvesting and Marketing**

43. The Grower is entitled to the Trees and Host Trees to be planted on the Woodlot and has a right to the timber from those trees. Harvesting will take place as and when deemed appropriate by the Manager in producing the best overall result for the Grower. The Manager expects to conduct thinning harvests of 150 trees per Woodlot in year 11 and 60 trees per Woodlot in year 15. The remaining trees (approximately 90 per Woodlot) will be harvested in the final year of the Project.

44. Growers may elect, on or before 30 June 2004, to harvest and sell their own timber by giving written notice to the Manager (clause 8.1) or the Manager will harvest and sell the timber on their behalf for the highest practicable price (clause 7). This Product Ruling does not apply to Growers who make such an election.

45. The proceeds from sale of all other Growers timber will be paid direct to the Responsible Entity who must deposit them into a Proceeds Fund. Separate Proceeds Funds will be created for Growers of Year 2002 Pre-paid Woodlots and Year 2003 Pre-paid Woodlots. The Responsible Entity shall pay the Grower's Share of the costs of harvest and sale as advised by the Manager, any outstanding fees or other amounts owing by the Grower to the Manager or Lessor. The balance will be distributed to the Growers on a proportionate basis. The term 'Proceeds Fund' is defined in the Constitution and the term 'Grower's Share' is defined in the Management Agreement.

## **Finance**

46. Growers can fund their participation in the Project themselves, or borrow from an independent lender.

47. This Ruling does not apply if a Grower enters into a finance agreement that 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' 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 terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved in the provision of finance for the Project.

## **Ruling**

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### **Application of this Ruling**

48. This Ruling applies only to Growers who are accepted to participate in the Project:

- on or before 30 June 2002, where the Grower has executed a Lease and a Management Agreement on or before that date to become a Grower of Year 2002 Pre-paid Woodlots; and/or
- on or after 1 July 2002 and before the expiry date of the Prospectus and only where the Grower has executed a Lease and a Management Agreement to become a Grower of Year 2003 Pre-paid Woodlots.

49. The Grower's participation in the Project must constitute the carrying on of a business of primary production. 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. This

Ruling does not apply to Growers who make an election to harvest and market timber produced from their Woodlot(s).

## **The Simplified Tax System ('STS')**

### **Division 328**

50. For a Grower who is accepted into this Project, the recognition of income and the timing of tax deductions will depend upon whether, in an income year(s), the Grower is an 'STS taxpayer' or is not 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**

51. 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***

52. 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.

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

### **Deductions for Establishment Fee, Planting Fee and Interest**

#### ***Section 8-1***

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

**Year 2002 Pre-paid Woodlots**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2002</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>
<b>Establishment Fee</b>	8-1	\$5,000 See notes (i) & (ii) below		
<b>Planting Fee</b>	8-1		\$450 See notes (i) & (ii) below	
<b>Interest (Term payment options)</b>	8-1	As incurred See note (iii) below	As incurred See note (iii) below	As incurred See note (iii) below

**Year 2003 Pre-paid Woodlots**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee</b>	8-1	\$5,000 See notes (i) & (ii) below		
<b>Planting Fee</b>	8-1		\$450 See notes (i) & (ii) below	
<b>Interest (Term payment options)</b>	8-1	As incurred See note (iii) below	As incurred See note (iii) below	As incurred See note (iii) below

**Notes:**

- (i) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 116.
- (ii) The Establishment Fee and the First Year Fee is expenditure for 'seasonally dependent agronomic activities' and is deductible in the income year in which it is incurred (see paragraphs 90 to 94 in the Explanations).
- (iii) Interest payable under either the 2 Year Terms Payment Option or 5 Year Terms Payment Option will be deductible when incurred.

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

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

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

**Deductions for Establishment Fee, Planting Fee and Interest*****Section 8-1 and section 328-105***

57. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the revenue expenses in the following Tables. However, if, for any reason, such as under the Terms Payment Options, an amount shown in the Tables below is not fully paid in the year in which it is incurred by a Grower who is an ‘STS taxpayer’, then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

**Year 2002 Pre-paid Woodlots**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2002</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>
<b>Establishment Fee</b>	8-1	\$5,000 See notes (iv), (v) & (vi) below		
<b>Planting Fee</b>	8-1		\$450 See notes (iv), (v) & (vi) below	
<b>Interest (Term payment options)</b>	8-1	When paid See note (vii) below	When paid See note (vii) below	When paid See note (vii) below

**Year 2003 Pre-paid Woodlots**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee</b>	8-1	\$5,000 See notes (iv), (v) & (vi) below		
<b>Planting Fee</b>	8-1		\$450 See notes (iv), (v) & (vi) below	
<b>Interest (Term payment options)</b>	8-1	When paid See note (vii) below	When paid See note (vii) below	When paid See note (vii) below

**Notes:**

- (iv) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 116.
- (v) The Establishment Fee and the First Year Fee is expenditure for 'seasonally dependent agronomic activities' and is deductible in the income year in which it is incurred (see paragraphs 90 to 94 in the Explanations).
- (vi) If a Grower who is an 'STS taxpayer' chooses to pay the \$5,000 Establishment Fee using the cash option, then that amount will be fully paid in the year in which it is incurred, and hence will be fully deductible. Similarly, the \$450 Planting Fee will be deductible in Year 1 as it will be fully paid in the year in which it is incurred.
- (vii) Interest payable under either the 2 Year Terms Payment Option or 5 Year Terms Payment Option will be deductible when paid.

**Tax outcomes that apply to all Growers****Interest**

58. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier, other than the Terms Payment Options offered by Forest Rewards Management Pty Ltd, is outside the scope of this Ruling. However all Growers who borrow funds in order to

participate in the Project, should read the discussion of the prepayment rules in paragraphs 82 to 89 (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 Growers choice.

### **Division 35 - deferral of losses from non-commercial business activities**

#### ***Section 35-55 – Commissioner's discretion***

59. For a Grower who is an individual, enters the Project during the years ended 30 June 2002 or 30 June 2003, and does not elect to harvest and market their own timber, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for Growers of Year 2002 Pre-paid Woodlots for the income years ending 30 June 2002 to 30 June 2021 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. Similarly, for Growers of Year 2003 Pre-paid Woodlots, the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2022 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

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

- the 'exception' in subsection 35-10(4) applies;
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- 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)).

61. 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 the deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

62. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph

35-55(1)(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**

63. For a Grower who participates in the Project and incurs expenditure as required by the Lease Agreement and the Management Agreement 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**

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### **Is the Grower carrying on a business?**

64. For the amounts set out in the Tables above to constitute allowable deductions the Grower's activities, as a participant in the Forest Rewards Sandalwood Project 2002 – Prepaid Woodlots, must amount to the carrying on of a business of primary production.

65. Where there is a business, or a future business, the gross proceeds from the sale of timber from the scheme will constitute assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

66. For schemes such as that of the Forest Rewards Sandalwood Project 2002, 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.

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

- the Grower has an identifiable interest (by lease or licence) in the land on which the Grower's trees are established;

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- the Grower has a right to harvest and sell the timber from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

68. In this Project each Grower enters into a Lease and a Management Agreement.

69. Under the Lease each individual Grower will have rights over a specific and identifiable area of at least 0.6 hectares of land. The agreement 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 agreement allows the Manager to come onto the land to carry out its obligations.

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

71. The Manager may also be engaged to harvest and sell, on behalf of the Grower, the timber grown on the Grower's leased area.

72. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

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

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

75. The Manager's services are also consistent with general afforestation practices. They are of the type ordinarily found in

afforestation ventures that would commonly be said to be businesses. While the size of a Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

77. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the Forest Rewards Sandalwood Project 2002 – Prepaid Woodlots, will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

78. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

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

## **Deductibility of lease and management fees**

### ***Section 8-1***

80. Consideration of whether the lease and management fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings 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 contractually commits themselves to a venture

that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

81. The management fees and lease fees associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber) 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 fees appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Prepayment provisions**

#### ***Sections 82KZL to 82KZMG***

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

83. For this Project only section 82KZL (an interpretative 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 'STS taxpayers' from the operation of section 82KZMF.

***Sections 82KZME and 82KZMF***

84. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

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

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

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

87. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the

purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

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

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

89. 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***

90. 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).

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

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

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

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

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

93. 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.

94. 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***

95. Under the Management Agreement, a Grower incurs an Establishment Fee of \$5,000 per Woodlot and a First Year Fee of \$450. These fees consist of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the expenditure is incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

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

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

97. Although not required under either the Management Agreement or the Lease, a Grower participating in the Project may **choose** to prepay the First Year Fee or interest for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either

choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 96 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 First Year Fees 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 fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

### **Division 35 - deferral of losses from non-commercial business activities**

100. 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.

101. 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.

102. 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.

103. For the purposes of applying the tests, 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.

104. 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 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).

105. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires more than one Woodlot in the Project during the years ended 30 June 2002 or 30 June 2003 may find that their activity meets one of the tests in a harvest year. However, a Grower who acquires the minimum allocation in the Project of one Woodlot is unlikely to ever pass one of the tests.

106. Therefore, 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.

107. 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:

- (i) because of its nature, the business activity has not yet satisfied, or will not satisfy one of the tests set out in Division 35; and
- (ii) 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.

108. Information provided with this Product Ruling application indicates that a Grower who acquires the minimum allocation of one

Woodlot in the Project and does not elect to harvest and market their own timber, is expected to be carrying on a business activity that will produce a taxation profit for the years ended 30 June 2014, 30 June 2018 and 30 June 2022 (Year 2002 Pre-paid Woodlots) or the years ended 30 June 2015, 30 June 2019 and 30 June 2023 (Year 2003 Pre-paid Woodlots).

109. The Commissioner will decide for such a Grower of Year 2002 Pre-paid Woodlots that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2021, and for Year 2003 Pre-paid Woodlots, until the year ended 30 June 2022. The taxation profits that are projected for the income years from the harvests in years 11 and 15 do not affect the period of the Commissioner's discretion as the income derived from the thinning harvests is considered to be a 'one-off' event that is specific to the afforestation industry.

110. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). However, the Project may fail to be carried on during the income years specified above (see paragraph 59) in the manner described in the Arrangement (see paragraphs 15 to 47). 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) the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

111. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the Independent Forester, and additional evidence provided with the application by the Manager; and
- independent, objective and generally available information relating to the Sandalwood industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

### **Section 82KL**

112. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(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**

113. 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).

114. The Forest Rewards Sandalwood Project 2002 – Prepaid Woodlots will be a ‘scheme’ commencing with the issue of the Prospectus. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 54 and 57 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

115. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. 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 with each other at arm’s length, or, if any parties are not at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

**Example****Example 1 - Entitlement to GST input tax credits**

116. 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:

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

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

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

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

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

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

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

## **Detailed contents list**

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**Commissioner of Taxation**

22 May 2002

*Previous draft:*

Not previously issued in draft form

- tax avoidance
- tax benefits under tax avoidance schemes

*Related Rulings/Determinations:*

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

- tax shelters
- tax shelters project

*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration

*Legislative references:*

- ITAA 1936 Div 3 of Part III
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)

- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
- ITAA 1936 82KZMG(5)
- ITAA 1936 Part IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- 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(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
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- ITAA 1997 328-105(1)(b)
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- FCT v. Lau 84 ATC 4929

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