

PR 2002/71 - Income tax: Campbell's River Project (2002 planting)

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 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: Campbell's River Project (2002 planting)

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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**, **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

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 law(s)' 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 Campbell's River Project (2002 planting), or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936);
 - Section 82KZMG (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a

number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential 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

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Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

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 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.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2002/23, which is withdrawn on and from the date this Ruling is made. Product Ruling PR 2002/23 will not apply to any investors as no investors will be accepted into the Project before the issue date of this Ruling.

Arrangement

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

- Application for Product Ruling for the Campbell's River Project (2002 planting) dated 9 August 2001;
- Draft Prospectus of the Campbell's River Project (2002 planting), undated;
- **Project Agreement, for the year 2002, of the Campbell's River Project (2002 planting) between Mount David Forestry Limited ("MDF", "Responsible Entity") and each Grower, received with the application for Product Ruling, undated;**
- Compliance Plan of the Campbell's River Project (2002 planting) received with the application for Product Ruling, version 1.4 dated 21 March 2001;
- Constitution of the Campbell's River Project (2002 planting), undated, received from the Applicant's representative on 9 November 2001;
- Draft Option To Lease Agreement between MDF and the owners of the lands set aside for the Project;
- Agreement between MDF and Oberon Forest Developers Pty Ltd dated 25 October 2000;
- Deed of Agreement between Mount David Group Pty Ltd ("MDG") and MDF dated 28 February 2001;
- Correspondence from the applicant's representative dated 22 & 23 October 2001, 9 & 30 November 2001, 21 December 2001 and 13 February 2002.
- Correspondence from the ATO to the Applicant's representative dated 24 September 2001, 29 & 31 October 2001, 12 November 2001 and 10 & 24 December 2001.

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

16. 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.

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

PR 2002/71**Overview**

18. This arrangement is called the Campbell's River Project (2002 planting).

Location	Oberon, New South Wales
Type of business each participant is carrying on	Commercial growing of <i>Pinus radiata</i> for the purpose of harvesting and selling of timber.
Number of hectares under cultivation	800
Size of each Stand	0.4 hectare
Expected production	60, 40 and 160 cubic metres per Stand at years 15, 24 and 28 respectively.
Minimum subscription per Grower	5 Stands
Minimum subscription for Project	52 Stands
Term of the Project	28 years
Initial cost	\$3,190 per Stand, consisting of: Ground Preparation fee \$2,558 Planting Service fee \$522 Year 1 Licence fee \$110
Initial cost per hectare	\$7,975
Ongoing costs	Licence and Supervision Fees of \$110 and \$33 per annum respectively (subject to CPI indexation after Year 3); Clearfall Harvesting Supervision Fee of 3.3% of the Grower's gross return; Optional Special Management Activities Fees as negotiated with MDF.

19. Growers participating in the arrangement enter into the Project Agreement providing for a licence of land, forest development and ongoing supervision for the term of the Project, which is estimated to be 28 years.

20. Each Grower must subscribe for a minimum of 5 Stands of 0.4 hectares each i.e., a minimum area of 2 hectares. Under the Project Agreement MDF will, on behalf of the Grower, plant and cultivate *Pinus radiata* seedlings at an appropriate stocking rate in accordance with sound silvicultural practices and will undertake to replant dead seedlings where more than 10% have died in the first 12 months. Ownership of the trees remains the property of the Grower (unless the licence is terminated for non payment of annual Licence fees). Three harvest periods are scheduled over the life of the Project, the first in approximately 15 years and the second in approximately 24 years with eventual clearfall to occur in approximately 28 years.

21. The projected returns depend on a range of assumptions and MDF does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project Agreement being offered pursuant to the Prospectus.

22. Under the Prospectus MDF proposes to offer 2000 Stands of 0.4 hectares each at a cost of \$3,190 per Stand. Ongoing annual Licence fees and maintenance fees are payable by the Grower. Certain costs of the Project have been underwritten by MDG. Under the Deed of Agreement between MDG and MDF, MDG acknowledges that it will not demand either repayment for expenses underwritten pursuant to clause 2.1 of the Deed or remuneration for any services rendered until the Campbell's River Project (2002 planting) reaches the subscription level of 200 Stands, or all the directors of MDF agree that such remuneration is able to be made without jeopardising the stability of MDF and the Campbell's River Project (2002 planting) and only after the directors of MDF are satisfied that, as directors of MDF, they have placed the interests of the Growers of the Campbell's River Project (2002 planting) first. MDF reserves the right to accept oversubscriptions.

23. The land available to the Project has been secured by an option to lease from related parties, which expire on 30 June 2002 as follows:

Property	Approx. Area
Greenhills	140 hectares
Shannon	230 hectares
Toondullie	675 hectares

24. Formal leases for a term of 30 years will be executed as property is required for the Project.

Project Agreement

25. The Project Agreement encompasses the licence to use the land, plantation preparation and management, planting and administration, ongoing maintenance and supervision, and marketing.

26. Growers enter into a licence to use the land for the sole purpose of conducting a forestry business for the term of the Project (clause 3). The Licence is conditional on the Grower establishing the business, paying the annual Licence fees and Supervision fees and paying any Special Management fees or Plantation Maintenance fees that are payable during the life of the Project (clause 4).

27. The performance of the ground preparation works and plantation services are to be undertaken by MDF in accordance with clause 13. These services are to be completed before the expiration of the Development Term which shall not exceed 12 months (clause 1.1). MDF will replace any dead seedlings if more than 10% have died in the first 12 months (clause 13.6).

28. MDF will supervise the plantation for the term of the Project including maintenance of fire trails and access roads, regular site visits, maintenance of identifying markers, basic supervision etc. for which it will receive an annual Supervision fee (clauses 16 to 18).

29. In accordance with clauses 19 and 20 MDF will identify any Special Management Activities (SMAs) or Plantation Maintenance activities which may be required or recommended. SMAs are optional and will be at the Growers' discretion (e.g., pruning) and cost. Growers acknowledge MDF may be required to undertake Plantation Maintenance and the Growers shall pay MDF the Plantation Maintenance fee within thirty (30) days of invoice. Plantation Maintenance includes, but is not limited to, weed control, fertilising, pest control and disease control. Growers are responsible for their own insurance requirements.

30. Growers may elect to collect their own timber at clearfall and thinnings, however MDF will conduct a thinning exercise unless otherwise directed by Growers. MDF will be available to provide assistance to the Grower in the harvesting, marketing and sale of the timber from the trees at clearfall and MDF shall be entitled to the Marketing fee. Clearfall must occur prior to the expiration of the term of the Project. **Growers who elect to collect their own timber and/or do not have SMAs undertaken will not be covered by this Product Ruling.**

Prospectus

31. The planting of seedlings can only occur in certain conditions generally between June and October each year. For this reason

Growers accepted up to and including 31 May 2002 will have completed ground preparation including acquisition of seedlings prior to 30 June 2002. For Growers accepted into the Project after 31 May 2002, ground preparation (including acquisition of seedlings) may be undertaken both before and after 30 June 2002. As the 'eligible service period' is less than 12 months and ends before the last day of the income year after the expenditure year, Growers will be issued an invoice for the ground preparation work when their participation is accepted.

32. For Growers accepted after 30 June 2002 MDF will have completed ground preparation (including acquisition of seedlings) and planting services prior to 30 June 2003.

33. MDF will develop the Stands for the Grower, including all land preparation, chemicals fertilisers and supply of seedlings, in accordance with sound silvicultural practices. Each Grower will receive a map of the Project clearly identifying the area allocated.

Fees

34. The Ground Preparation fee of \$2,558 and the Year 1 Licence fee are payable on application. The term covered by the Year 1 Licence fee is from the date a Grower enters the Project Agreement to 30 June in the year which first occurs after 12 months from the date of the agreement. The Licence fee for subsequent years is payable in advance, on or before 30 April. The Licence fee will be \$110 per year for the first 3 years after which it will be increased by the Review Fraction as defined in the Project Agreement.

35. The Planting Service fee of \$522 is payable by 1 October 2002 where applications are lodged before 1 October 2002. The Planting Service fee is payable on application where the application is made after 1 October 2002.

36. The Supervision fee will be \$33 for the first three years after which it will be increased by the Review Fraction. The Supervision fee is payable annually on 30 April in each year calculated in arrears.

37. The following fees are payable in the year indicated where Growers are accepted into the Project before 30 June 2002.

	Year 1 (Year Ended 30 June 2002)	Year 2 (Year Ended 30 June 2003)	Year 3 (Year Ended 30 June 2004)
Ground Preparation fee	\$2,558		
Planting Service fee		\$522	
Licence fee	\$110	\$110	\$110
Supervision fee		\$33	\$33

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38. The following fees are payable in the year indicated where Growers are accepted into the Project after 30 June 2002 and before 30 June 2003.

	Year 1 (Year Ended 30 June 2002)	Year 2 (Year Ended 30 June 2003)	Year 3 (Year Ended 30 June 2004)
Ground Preparation fee		\$2,558	
Planting Service fee		\$522	
Licence fee		\$110	\$110
Supervision fee			\$33

39. In addition to the above fees Growers will be liable for the cost of any Special Management Activities and Plantation Maintenance undertaken by MDF. The Plantation Maintenance fee is payable to MDF within 30 days of invoice. MDF will be entitled to a Marketing fee of 3.3% of a Growers Gross Return from clearfall where MDF assists in the harvesting, marketing or sale of the timber.

40. The Application monies will be held by the custodian until released to MDF on acceptance of application to enable plantation establishment. Clause 4.2 of the Constitution enable MDF to accept applications before all application monies are paid. This can only occur in circumstances where finance has been approved or the Grower is waiting for the release of available funds. Where a Grower fails to pay the application monies due within 30 days of acceptance then the Grower shall not be covered by this Product Ruling.

Finance

41. 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; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

42. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 June 2003 and who have executed a Project Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

43. 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. A Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 52 Stands is achieved.

The Simplified Tax System ('STS')

Division 328

44. 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

45. 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.

Prepaid expenditure for Ground Preparation fees and Licence fees

Sections 82KZME and 82KZMF

46. The Following expenditure incurred by a Grower who is accepted into this Project is subject to the prepayment rules in sections 82KZME and 82KZMF:

- \$476 per Stand for that part of the Ground Preparation fee that is not expenditure that is deductible under section 82KZMG (see below);
- \$110 per Stand for Licence fees.

47. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Other than expenditure deductible under 82KZMG, where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see notes (iii) and (v) below).

48. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

49. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 86 to 91.

Prepaid expenditure for ‘seasonally dependent agronomic activities’***Section 82KZMG***

50. Where certain advance expenditure, and the agreement under which that expenditure is incurred, meets the requirements of section 82KZMG, the formula in subsection 82KZMF(1) will not operate to determine the timing of the deduction allowable. The requirements of section 82KZMG are set out below in paragraphs 92 to 96.

51. Among other things, expenditure that complies with section 82KZMG must be for ‘seasonally dependent agronomic activities’ that are carried out by the manager during the Project’s ‘establishment period’. The ‘eligible service period’ relating to this expenditure must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year.

52. Under the Project Agreement, for each Stand, a Grower incurs \$2,603 (\$2,082 Ground Preparation fee and \$522 Planting Service fee) for ‘seasonally dependent agronomic activities’. This expenditure is deductible in the income year that the Grower incurs this amount.

Tax outcomes for Growers who are not ‘STS taxpayers’**Assessable Income*****Section 6-5***

53. 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.

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

Deductions for Ground Preparation fee, Planting Service fee, Licence fees and Supervision fees***Section 8-1***

55. A Grower who is not an ‘STS taxpayer’, who invests in the Project on or before 30 June 2002, may claim tax deductions for the following revenue expenses:

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Fee type	ITAA 1997 section	Year Ended 30 June 2002	Year Ended 30 June 2003	Year Ended 30 June 2004
Fees for 'seasonally dependent agronomic activities'	8-1	\$2,082 See Notes (i) & (ii) (below)	\$522 See Notes (i) & (ii) (below)	
Other Ground Preparation fees	8-1	\$476 See Notes (i) and (iii) (below)		
Licence fees	8-1	\$110 See Notes (i) & (v) (below)	\$110 See Notes (i) & (v) (below)	\$110 See Notes (i) & (v) (below)
Supervision fees	8-1		\$33 See Notes (i) & (iv) below	\$33 See Notes (i) & (iv) below

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example 1 at paragraph 118.
- (ii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (iii) The Ground Preparation fee shown in the Table at paragraph 37 above is NOT deductible in full in the year incurred except to the extent that this fee is for 'seasonally dependent agronomic activities' (see Note (ii)). The deduction for that part of the Ground Preparation fee that is not for 'seasonally dependent agronomic activities' must be determined using the formula in subsection 82KZMF(1) (see paragraph 48). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the income year ended 30 June 2002. This figure is necessary to calculate the deduction allowable for the fees incurred in that year. (See Example 2 at paragraph 119.
- (iv) The Supervision fees shown in the Project Agreement are deductible in full in the year that they are incurred. However, if a Grower chooses to prepay fees for the doing of a thing that will not be wholly done in the

income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 47 unless the expenditure is 'excluded expenditure or 'seasonally dependant agronomic activities', in which case, an immediate deduction would be allowed.

- (v) Although the Project Agreement requires the Licence fee to be prepaid, for a Grower who acquires the minimum allocation, the amount of the prepaid Licence fee is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 120). However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid Licence fee may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the deduction for the prepaid Licence fee using the formula in subsection 82KZMF(1) (see paragraph 48). MDF will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable where the fees incurred are \$1,000 or more. (See example 2 at paragraph 119).

56. A Grower who is not an 'STS taxpayer', who invests on or after 1 July 2002 and on or before 30 June 2003, may claim tax deductions for the following revenue expenses:

Fee type	ITAA 1997 section	Year Ended 30 June 2003	Year Ended 30 June 2004
Fees for 'seasonally dependent agronomic activities'	8-1	\$2,603 See Notes (i) & (ii) (above)	
Other Ground Preparation fees	8-1	\$476 See Notes (i) and (iii) (above)	
Licence fees	8-1	\$110 See Notes (i) & (v) (above)	\$110 See Notes (i) & (v) (above)
Supervision fees	8-1		See Note (i) & (iv) (above)

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

57. 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.

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

Deductions for Ground Preparation fee, Planting Service fee, Licence fees and Supervision fees**Section 8-1 and section 328-105**

59. A Grower who is an ‘STS taxpayer’, who invests in the Project on or before 30 June 2002, may claim tax deductions for the following revenue expenses:

Fee type	ITAA 1997 section	Year Ended 30 June 2002	Year Ended 30 June 2003	Year Ended 30 June 2004
Fees for ‘seasonally dependent agronomic activities’	8-1	\$2,082 See Notes (vi) & (vii) (below)	\$522 See Notes (vi) & (vii) (below)	
Other Ground Preparation fees	8-1	\$476 See Notes (vi) and (viii) (below)		
Licence fees	8-1	\$110 See Notes (vii), (ix) & (x) (below)	\$110 See Notes (vi), (vii) & (x) (below)	\$110 See Notes (vi), (vii) & (x) (below)
Supervision fees	8-1		\$33 See Notes (vi), (vii) & (ix) (below)	\$33 See Notes (vi), (vii) & (ix) (below)

Notes:

- (vi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits):
See example 1 at paragraph 118.

- (vii) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (viii) The Ground Preparation fee shown in the Table at paragraph 37 (in the Arrangement) above is **NOT** deductible in full in the year in which it is paid by, or on behalf of an STS taxpayer, except to the extent that this fee is for 'seasonally dependent agronomic activities' (see Note (ix)). The deduction for that part of the Ground Preparation fee that is not for 'seasonally dependent agronomic activities' must be determined using the formula in subsection 82KZMF(1) (see paragraph 48). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the income year ended 30 June 2002. This figure is necessary to calculate the deduction allowable for the fees incurred in that year. (See Example 2 at paragraph 119).
- (ix) Where a Grower who is an 'STS taxpayer', pays the Supervision fees in the relevant income years shown in the Project Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of supervision services) 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. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 48, unless the expenditure is 'excluded expenditure';
- (x) Although the Project Agreement requires the Licence fee to be prepaid, for a Grower who acquires the minimum allocation, the amount of the prepaid Licence fee is less than \$1,000. For the purposes of this Project, amounts of less than \$1,000 are 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and it is therefore deductible in full in the year in which it is paid (see Example 3 at paragraph 120). However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid Licence fee may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the deduction for the prepaid Licence fee using the formula shown above in paragraph 48. MDF will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is

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necessary to calculate the deduction allowable where the fees incurred are \$1,000 or more. (See example 2 at paragraph 119).

60. A Grower who is an ‘STS taxpayer’, who invests on or after 1 July 2002 and on or before 30 June 2003, may claim tax deductions for the following revenue expenses:

Fee type	ITAA 1997 section	Year Ended 30 June 2003	Year Ended 30 June 2004
Fees for ‘seasonally dependent agronomic activities’	8-1	\$2,603 See Notes (vi) & (vii) (above)	
Other Ground Preparation fees	8-1	\$476 See Notes v(i) and (viii) (above)	
Licence fees	8-1	\$110 See Notes (vi) & (x) (above)	\$110 See Notes (vi) & (x) (above)
Supervision fees	8-1		See Note (vi) & (ix) (above)

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

61. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier 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 84 to 101 (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.

Division 35 – Deferral of losses from non-commercial business activities***Section 35-55 – Commissioner’s discretion***

62. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 or 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 2002 to 30 June 2029 where a Grower is accepted into the Project in the

2002 year of income, or the income years ending 30 June 2003 to 30 June 2030 where a Grower is accepted into the Project in the 2003 year of income, 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.

63. 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 105 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the objective 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)).

64. 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.

65. 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.

Sections 82KL, and Part IVA

66. For a Grower who participates in the Project and incurs expenditure as required by the Project 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

Is the Grower carrying on a business?

67. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the Campbell's River Project (2002 planting) must amount to the carrying on of a business of primary production.

68. 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.

69. For schemes such as that of the Campbell's River Project (2002 planting), 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.

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

- The Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest 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.

71. In this Project, each Grower enters into a Project Agreement. Under the Project Agreement each individual Grower will have rights in the form of a Licence over a specific and identifiable area of land. The Project Agreement provides the Grower with an ongoing interest in the specific trees on the licenced) area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other

purpose. The licence allows MDF to come onto to the land to carry out its obligations under the Project Agreement.

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

73. MDF is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Stands.

74. 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.

75. 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.

76. The pooling of wood produce from trees grown on the Grower's Stands 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 Stands.

77. MDF's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a Stand is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

79. 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 Campbell's River Project (2002 planting) will constitute the carrying on of a business.

The Simplified Tax System

Division 328

80. 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.

81. 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 Ground Preparation fee, Planting Service fee, Licence fees and Supervision fees

Section 8-1

82. Consideration of whether the initial Ground Preparation fee, Planting Service fee, Licence fees and Supervision fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

83. The Ground Preparation fee, Planting Service fee, Licence fees and Supervision 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 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 fees appears to be reasonable. There is no capital

component of the Ground Preparation fee, Planting Service fee, Licence fees and Supervision 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

84. 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.

85. 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

86. 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)).

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

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the

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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.

88. 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. 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.

89. 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.

90. 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.

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

91. 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

92. 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).

93. 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.

94. 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:
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

95. 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.

96. 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

97. Under the Project Agreement, a Grower incurs the Ground Preparation fee of \$2,558 consisting of expenditure of \$2,082 for 'seasonally dependent agronomic activities' and expenditure of \$476 for other activities on acceptance into the Project. The Planting Service fee of \$522 is payable by 1 October 2002 where a Grower is accepted into the Project before 1 October 2002. The Planting Service fee is payable on application where the application is made after 1 October 2002. The Planting Service fee are for 'seasonally dependent agronomic activities'.

98. As the requirements of section 82KZMG have been met, a deduction is allowable in the income years ended 30 June 2002 and 30 June 2003 for the expenditure incurred under the Project Agreement for 'seasonally dependent agronomic activities'. The expenditure incurred under the Project Agreement for Licence fees meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

99. That part of the prepaid Ground Preparation fee incurred by a Grower for ground preparation services that are not 'seasonally dependent agronomic activities' does not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for this expenditure is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for this part of the prepaid Ground Preparation fee over the period that the services, for which the prepayment is made, are provided.

100. The prepaid Licence fees of \$110 per Stand, will be an amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the Licence 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 the Licence fees in the income year in which the fee is incurred.

101. However, where a Grower acquires more than the minimum investment of 5 Stands interests in the Project and the quantum of the prepaid Licence fee is \$1,000 or more, the deduction allowable for

these amounts will instead be subject to apportionment according to the formula in subsection 82KZMF(1).

Deferral of losses from non-commercial business activities

Division 35

102. 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.

103. 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.

104. 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.

105. 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.

106. In broad terms, the objective 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);

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

107. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of 5 Stands in the Project is unlikely to have their activity pass one of the objective tests until the income year ended 30 June 2026. Growers who acquire more than 5 Stands in the Project may however, find that their activity meets one of the tests in an earlier income year.

108. 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.

109. 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, it 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.

110. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of 5 Stands in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2026.

111. 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 year ended 30 June 2029 for a Grower accepted into the Project in the 2002 year of income, or the year ended 30 June 2030 for a Grower accepted into the Project in the 2003 year of income. The taxation profit that is projected for the income year ended 30 June 2016 and 2025, for Growers accepted into the Project in 2002, and 30 June 2017 and 2026, for Growers accepted into the Project in 2003, do not affect the period of the

Commissioner's discretion as they are considered to be 'one-off' events that are specific to the afforestation industry.

112. 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 paragraphs 31 and 32), in the manner described in the Arrangement (see paragraphs 15 to 41). 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.

113. 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 professional forester provided with the application by MDF;
- independent, objective, and generally available information relating to the pine plantation industry provided by MDF; and
- research undertaken by officers of the Australian Taxation Office.

Section 82KL - recouped expenditure

114. 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

115. 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).

116. The Campbell's River Project (2002 planting) 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 55, 56, 59 and 60 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.

117. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the wood produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example 1 - Entitlement to GST input tax credits

118. 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 \$4000 (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

119. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees for each Woodlot are \$5,000 in Year 1, consisting of \$4,500 for ‘seasonally dependent agronomic activities’ undertaken by the manager during the ‘establishment period’ and \$500 for other management activities. The management fee for Year 2 and 3 is \$400. 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 makes an application for 3 Woodlots in the project and 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.

First, that part of the Year 1 management fees that is for ‘seasonally dependent agronomic activities’, is deductible in full in the income year ended 30 June 2002. As Murray has 3 interests in the project this amount is (\$4,500 x 3) \$13,500.

Murray is also entitled to part of the deduction for the management fees related to other management activities (ie, those management activities that are not ‘seasonally dependent agronomic activities’). This amount is determined using the following formula.

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

$$\$1,500 \times \frac{26}{365}$$

= **\$107** (therefore Murray's total tax deduction in 2002 for 3 Woodlots for the Year 1 prepaid management fees of \$15,000 is \$13,607. It represents the sum of the amount paid for 'seasonally dependent agronomic activities' plus an amount for the 26 days for which the other 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:

$$\$1,500 \times \frac{339}{365}$$

= **\$1,393** (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 3 Woodlots for the 26 days during which services were provided to Murray in the 2003 income year).

\$1,393 + \$85 = \$1,478 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

For the term of the project, Murray continues to use this method to calculate his tax deduction for the prepaid management fees for his 3 Woodlots.

Example 3 – Apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

120. On 1 June 2002 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his 1 hectare Woodlot and the provision of management services between the 1 July and 30 June in the following income year. On 15 June 2002 Kevin pays the Year 1 lease fee of \$400 and the Year 1 management fee of \$8,600. The Year 1 management fee is made up of \$7,500 for 'seasonally dependent

agronomic activities' undertaken by the manager during the 'establishment period' and \$1,100 for other management services.

Kevin, who is not an 'STS taxpayer' is not registered, nor required to be registered for GST.

He calculates his tax deduction for management fees and the lease fee for the **2002 income year** as follows:

Management fee

Even though he paid the \$8,600 in the 2002 income year, Kevin is only able to claim a deduction of \$7,500 for the 'seasonally dependent agronomic expenditure' in that income year. Because there are no 'days of eligible service period' in the 2002 income year, Kevin is unable to claim any part of the management fees paid to the manager for other management services, as a tax deduction in his tax return for the year ended 30 June 2002.

Lease fee

Because the \$400 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2002.

In the **2003 income year** Kevin can claim a tax deduction for that part of his first year's management fees that was not deductible in the 2002 income year. The tax deduction is calculated as follows:

$$\begin{array}{r} \$1,100 \quad \times \quad \frac{365}{365} \\ \hline \end{array}$$

= **\$1,100** (this represents the whole of that part of the first year's management fee prepaid in the 2002 income year for management services that are not 'seasonally dependent agronomic activities' undertaken by the manager in the 'establishment period'. Although this amount was incurred in the 2002 income year it is not deductible until the 2003 income year).

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

Detailed contents list

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

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Related Rulings/Determinations:

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 TR 92/20; TR 97/11; TR 97/16;
 TR 98/22; TR 2000/8; TD 93/34;
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Subject references:

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance
- schemes
- tax shelters

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