



PR 2002/84 - Income tax: ITC Eucalypt Project 1998

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Product Ruling

Income tax: ITC Eucalypt Project 1998

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Preamble

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

No guarantee of commercial success

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

Participants must form their own view about the commercial and financial viability of the products. 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 investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'ITC Eucalypt Project 1998' or simply as 'the Project'.

Tax law(s)

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

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who were accepted into the Project between 24 April 1998 and 24 April 1999. 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 have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project. Growers who elect to collect and market their own produce are also excluded from the class of persons to whom this Ruling applies (see paragraphs 29 and 39).

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 12 June 2002 for Growers who, between 24 April 1998 and 24 April 1999, entered into the arrangement that is set out in below. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not

yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, even following its withdrawal, in respect of the tax laws ruled upon, to all persons within the specified class who, between 24 April 1998 and 24 April 1999, entered into the specified arrangement that is set out below. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- ITC Eucalypt Project 1998 Prospectus, dated 24 April 1998;
- ITC Eucalypt Project 1998 Supplementary Prospectus, dated 25 June 1998;
- **Trust Deed for the ITC Eucalypt Project 1998 between ITC Project Management Limited [‘Manager’] and the Trustee, dated 18 March 1998;**
- **Supplementary Deed to the Trust Deed [‘Constitution’] for the ITC Eucalypt Project 1998 by ITC Project Management Ltd [Responsible Entity], dated 31 May 2000;**
- **Lease Agreement between Integrated Tree Cropping Pty Ltd [the ‘Lessor’] and the Grower, undated;**
- **Plantation Management Agreement between ITC Project Management Limited [the ‘Manager’] and the Grower, undated;**
- Head Lease Agreements between the ‘Landlord’, Integrated Tree Cropping Pty Ltd [the ‘Tenant’] and the Manager, undated;

- Contracting Agreement between Integrated Tree Cropping Pty Ltd [the 'Plantation Manager'] and the Manager dated 24 April 1998;
- ITC Tree Farm Loan Package for the ITC Eucalypt Project 1998, undated; and
- additional correspondence from the Applicant dated 14 December 2001 and 30 May 2002.

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

15. The documents highlighted are those that the Growers entered into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, was or is a party to.

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

Overview

17. This arrangement is called the ITC Eucalypt Project 1998.

Location	Green Triangle Region of Victoria and South Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of <i>Eucalyptus globulus</i> (Tasmanian Blue Gum) trees for the purpose of producing timber for pulp wood.
Number of hectares under cultivation	494.2 hectares
Size of each leasehold area	Variable sizes each of which is a minimum of 10 hectare
Number of trees per hectare	Variable depending on the size of the Leased Area
The term of the Project	Approximately 10 years
Initial cost per Leased Area	Variable depending on the size of the Leased Area
Initial cost per hectare	Variable depending on the size of the

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	Leased Area
Ongoing costs	Annual rent, annual management fees, harvesting costs and insurance (optional)

18. Growers who participate in this Arrangement entered into a Lease Agreement and Plantation Management Agreement for the Project. These Agreements are set out in Schedules 1 and 2 to the Constitution. For the purposes of this Ruling, those Growers who entered into the Project before 30 June 1998 will be referred to as '1998 Growers'. Those Growers who entered into the Project after 30 June 1998 but before 24 April 1999 will be referred to as '1999 Growers'.

19. The Project Land is situated in the Green Triangle region of Victoria and South Australia. The Landlord has leased the land to Integrated Tree Cropping Pty Ltd (the 'Lessor'). The Lessor has sub-leased to each Grower an area of land called a 'Leased Area' for the period being the later of 30 June 2010 or the date of the completion of the harvest, for the purpose of carrying out a long term commercial silvicultural business. Each leased area varies in size depending on which property the Leased Area is situated on, but all are a minimum of 10 hectares in size.

20. There was no minimum subscription under the Prospectus. Each Grower subscribed for a minimum of one Leased Area at a cost which depended on the size of the leased area.

Constitution

21. The Constitution for the Project sets out the terms and conditions under which the Responsibility Entity agrees to act for the Grower and to manage the Project. The Responsible Entity will keep a register of Growers (cl.27).

22. The Lease Agreement and Plantation Management Agreement form the First and Second Schedules to the Constitution. Growers executed a Power of Attorney enabling the Responsible Entity, to act on their behalf when required, when an application was made for a Leased Area. Growers are bound by the Constitution by virtue of their participation in the Project.

Compliance Plan

23. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Under the Compliance Plan, a Compliance Committee will monitor to what extent the

Responsible Entity meets its obligations as the Responsibility Entity of the Project and the Growers rights are protected.

Interest in Land

24. Growers participating in this Project have entered into a Lease Agreement between the Lessor and the Grower. Growers have been granted an interest in land in the form of a sub-lease to use their Leased Area for the purpose of carrying on a commercial silvicultural business. The term of the Lease Agreement is until 30 June 2010 or the date of the completion of the harvest, whichever happens last.

25. Each Grower is required to pay rent to the Lessor for each year of the Project in the amounts specified in Item 5 of the Lease Agreement.

Plantation Management Agreement

26. Under the Plantation Management Agreement each Grower appointed the Manager to establish and maintain the plantation until maturity. Each Grower is required to pay Management Fees to the Manager for each year of the Project in the amounts specified in Item 3.2 of the Plantation Management Agreement.

27. The Manager will perform the following annual services for the duration of the Project:

- maintain, supervise and manage on a day to day basis the plantation and commercial silvicultural activities to be carried on by the Grower on the Leased Area;
- cultivate, tend, fertilise and otherwise care for the trees as and when required;
- in spring of the year of planting replace any area that have a greater than 10 seedlings dead or missing;
- use all reasonable measures to keep the leased area free from vermin, noxious weeds, pests and diseases;
- maintain the leased area according to good silvicultural practices; and
- monitor and report the outcome when industry trends and development of alternative products could affect the economic return from the Tree Crop.

28. All Growers may unanimously elect not to conduct a joint harvest of the timber (cl.10.1). If all Growers do not make such an election, each Grower is deemed to have appointed the Manager as the Grower's agent for the purpose of marketing the trees from the Leased

Area (cl 10.5). The Manager will use reasonable endeavours to market and sell the trees (cl. 10.1).

Fees

29. The initial fee paid under the Lease Agreement and Plantation Management Agreement consisted of rent, a plantation establishment fee and the first annual management fee for the period following the initial period. The initial period for 1998 Growers was the period from commencement until 30 June 1998, and for 1999 Growers the period from commencement to 30 June 1999.

30. The plantation establishment fee was equal to \$4,700 plus \$1,680 for each hectare in the Leased Area for services to be provided in the initial period.

31. Annual management fees were/are payable in two instalments on 30 June and 31 December of the relevant calendar year. The amount of fee payable was/is \$300 plus \$70 for each hectare of the Leased Area. All annual management fees paid or payable after 30 June 2000 have been increased to include GST. For 1998 Growers the first annual management fee was payable in two equal instalments on 30 June 1998 and 31 December 1998, and for 1999 Growers the instalments were payable on 30 June 1999 and 31 December 1999. These amounts were/are adjusted annually for any increase in the CPI since 30 June of the previous year commencing 30 June 1999 for both 1998 Growers and 1999 Growers.

32. The amount of rent paid was dependant on what property the Leased Area was situated on. The base annual rent is equal to the amount payable by the Lessor to the Landholder under the Head Lease Agreement, which ranges between \$120 and \$180 per hectare depending on the estimated productivity for each property and its distance to the nearest port or pulp mill. 1998 Growers paid an amount of initial rent equal to 150% of the base annual rent in advance by 30 June 1998 for the period 1 July 1998 to 30 June 1999. 1999 Growers paid an amount of initial rent equal to 50 % of the base annual rent by 30 June 1998 or whenever the Lease Agreement was executed, whichever happened last for the period from commencement until 30 June 1999.

33. For each year thereafter rent was/is payable in advance on 30 June of the relevant year. The amount of rent payable was/is 105% of the base annual rent payable under the Head Lease Agreement. All rent paid or payable after 30 June 2000 have been increased to include GST. These amounts were/are adjusted annually for any increase in the CPI since 30 June of the previous year commencing 30 June 1999 for both 1998 Growers and 1999 Growers.

34. All Growers must also pay a fee of 5.5% of the gross proceeds of sale of the Tree Crop to the Manager for preparing a harvest plan irrespective of whether an unanimous election is made by not to conduct a joint harvest of the timber.

35. If the Growers do not elect to harvest and sell their own timber, the proceeds from the sale of the trees after harvest, will be deposited into the Proceeds Fund. The Trustee will apply the balance of net sale proceeds in the Proceeds Fund in the following order:

- any amounts payable by Grower to the Lessor, under the Lease Agreement;
- any amounts payable by Grower to the Manager, under the Plantation Management Agreement; and
- by paying the balance of the produce fund to each of the Growers in proportion to their proportional interest in the fund.

Finance

36. Growers can fund their involvement in the Project by borrowing from ITC Finance Pty Ltd (a lender associated with the Manager).

37. Those Grower may enter into the following finance arrangement:

- 4 Year principal and interest loan;
- fixed interest rate of 11%; and
- quarterly repayments of capital and prepayment of interest in June of each relevant year.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;

- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than ITC Finance Pty Ltd are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

39. This Ruling applies only to Growers who were accepted to participate in the Project during the period 24 April 1998 and 24 April 1999. This Ruling does not apply if all Growers unanimously elect not to conduct a joint harvest of the timber.

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

Section 35-55 – Commissioner's discretion

40. For a Grower who is an individual and who entered the Project between 24 April 1998 and 24 April 1999 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. For 1998 Growers, under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2007 that the rule in section 35-10 does not apply to this business activity. For 1999 Growers, under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2008 that the rule in section 35-10 does not apply to this business activity. This is provided that the Project has been, and continues during the remainder of the term of the Project to be, carried on in a manner that is not materially different to that is set out in paragraphs 14 to 38 of this Product Ruling.

41. 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 47 in the Explanations part of this ruling, below);
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- 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)).

42. 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.

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

Explanations

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

44. 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.

45. 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.

46. 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.

47. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

48. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

49. A Grower who was accepted into and who has participated in the Project between 24 April 1998 and 24 April 1999 is carrying on a business activity that is subject to these provisions.

50. Information provided indicates that a Grower who acquired the minimum allocation of one interest(s) in the Project is unlikely to have their business activity pass one of the tests.

51. 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.

52. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has

no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

53. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of one interest in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2008 for 1998 Growers or 30 June 2009 for 1999 Growers. The Commissioner has decided for 1998 Growers that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2007. For 1999 Growers the Commissioner has decided that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2008.

54. The applicant has stated that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in paragraphs 14 to 38 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 40), in the manner described in the arrangement this Ruling may be affected. Specifically, the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

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

Detailed contents list

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

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Previous draft:

Not previously issued in draft form

*Related Rulings/Determinations:*PR 1999/95; TR 92/1; TR 92/20;
TR 97/16; TR 98/22; TD 93/34*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

Legislative references:

- TAA 1953 IVAAA
- ITAA 1936 82KL
- ITAA 1936 Pt IVA
- 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)
- Copyright Act 1968
- Corporations Act 2001

ATO references:

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