Australian Taxation Office

Product Ruling
Income tax: ITC Pulpwood Project 2003

Contents Para

Potential participants may wish to refer to the ATO's Internet site at **http://www.ato.gov.au** or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

Preamble

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

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

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.

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 relates. In this Ruling this arrangement is sometimes referred to as the 'ITC Pulpwood Project 2003', the 'Pulpwood Project' or just simply as 'the Project'.

Tax law(s)

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

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

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws 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 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 as set out in the description of the arrangement. 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. Growers who elect to market their own produce are also excluded from the class of persons to whom this Ruling applies.

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.

Date of effect

11. This Ruling applies prospectively from 24 April 2003, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. 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 persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 24 January 2003 as constituted by documents provided on 28 January 2003, 24 February 2003 and 28 March 2003 and additional correspondence dated 10 February 2003, 24 February 2003 and 28 March 2003;
- Draft Prospectus issued by ITC Project Management Ltd ('ITCPM'), received 28 January 2003;
- Draft **Management Agreement** for the ITC Pulpwood Project 2003 between ITCPM and the Grower, received 28 January 2003;
- Draft Memorandum (Management Agreement Provisions) for the ITC Pulpwood Project 2003, received 28 March 2003;
- Draft **Agreement to enter into Land Agreement**, received 28 January 2003;
- Draft **Land Agreement** for the ITC Pulpwood Project 2003 between ITCPM and the Grower, received 28 January 2003;
- Draft Memorandum (Land Agreement Provisions) for the ITC Pulpwood Project 2003, received 28 January 2003;
- Draft Scheme Constitution of the ITC Pulpwood Project 2003, received 28 January 2003;
- Draft **Finance Package** for the ITC Pulpwood Project 2003, received 28 January 2003;
- Draft Compliance Plan of the ITC Pulpwood Project 2003, dated 20 December 2002; and
- Independent Forester's Report dated 20 January 2003.

Note: certain information 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 Growers will or may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or

any associate of a Grower, will be a party to, which are a part of the arrangement to which this Ruling applies.

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

Overview

17. The salient features of the ITC Pulpwood Project 2003 arrangement are as follows:

Locations	• The Esperance region on the Western Australian south coast; • the Green Triangle region of western Victoria and south-eastern South Australia; and • the Bundaberg/Gladstone region of central Queensland.
Type of business each participant is carrying on	Commercial growing and cultivation of: • Tasmanian Blue Gum (*Eucalyptus globulus*); • Flooded Gum (*Eucalyptus grandis*); and/or • Flooded Gum/River Red Gum hybrid (*Eucalyptus grandis x Eucalyptus camaldulensis*) and other hybrids; for the purpose of harvesting and selling timber.
Number of hectares offered for cultivation	Approximately 5,000 hectares
Size of each interest (Plantation Unit)	Generally between 1 and 2 hectares
Minimum allocation	2 Plantation Units
Number of trees established per hectare	Between 700 to 1,000 (sufficient to meet expected production)
The term of the Project	Approximately 10 years
Initial minimum cost	$2,200 per Plantation Unit plus $1,100 per Grower.
Ongoing and other costs	Planting Services Fees Land and Forestry Services Fees, that are deferred until harvest. (The Grower can

	choose to pay an Annual Land and Forestry Fee in any or all of the Project's years. Such payments will reduce the Land and Forestry Services Fees.) Costs of harvest. Harvesting and marketing costs payable from harvest proceeds. Optional insurance costs (Compulsory for Growers who enter into the Finance Package).

18. The Project will be a registered Managed Investment Scheme under the Corporations Act. The Responsible Entity for this Project is ITC Project Management Ltd ('ITCPM'). The Prospectus offers the choice of 3 Projects to be managed by the Responsible Entity:

- The ITC Pulpwood Project 2003;
- The ITC Solidwood Project 2003; and
- The ITC Sandalwood Project 2003.

19. This Ruling only applies to the Pulpwood Project. ITCPM has acquired 1,375 hectares of land and may acquire up to another 3,625 hectares for the Project. The land is leased from ITC Timberlands Ltd, a related entity and from unrelated landowners. The Land secured for the Project has been deemed by the Independent Forester to be suitable for the establishment of a Eucalyptus plantation. There is no minimum subscription for the Project.

20. Under this offer, a Grower may enter the Project in either the 2002/2003 income year (defined as a '2003 Grower' for the purposes of this Ruling) or the 2003/2004 income year ('2004 Grower').

21. Growers participating in the arrangement will enter into a Land Agreement with ITCPM. The Land Agreement is executed over an identifiable area of land called a 'Plantation Unit' and is effective until the trees are harvested and sold and the net income distributed. Each Plantation Unit will generally comprise an area of between one and two hectares depending on the assessed productivity of the property and will be identified on the Responsible Entity's plantation plan.

22. Growers will also enter into a Management Agreement with ITCPM for the management of their Plantation Area. ITCPM will be responsible for establishing, cultivating and harvesting the trees. The trees are expected to be harvested approximately 10 years after planting. Unless the Grower elects to take possession of their timber, ITCPM will also arrange for the sale of the timber.

23. To participate in the Project, Growers must pay fees for Primary Services and Planting Services. The balance of the fees, including a Forestry Services Fee and Land Fee are payable after the final harvest. As an alternative to paying all or part of the Forestry Services and Land Fee after the final harvest, a Grower may choose to pay an Annual Forestry Services Fee and an Annual Land Fee in respect of all or any or all of the years in the Project.

24. Each Grower is required to subscribe for a minimum of two Plantation Units.

25. Upon application, Growers will execute a Power of Attorney enabling ITCPM to act on their behalf as required.

Constitution

26. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution set out the terms and conditions under which ITCPM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

27. Under the terms of the Constitution, all moneys received from applications shall be paid to ITCPM as the Responsible Entity, which shall deposit those moneys into an Application Fund. The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 8 and 9 of the Constitution).

28. The Responsible Entity will also:

- prepare the Management Agreement and the Land Agreement (clause 6);
- keep a register of Growers (clause 27); and
- distribute the proceeds of sale of the timber products (clause 30).

Compliance plan

29. ITCPM has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Land Agreement

30. Upon application, ITCPM will execute a Land Agreement on behalf of the Grower under a Power of Attorney. The agreement will be for an area of land identified as suitable for silviculture.

31. Growers acquire an interest in land called a Plantation Unit. The size of each Plantation Unit will generally be between one and two hectares. The exact size is calculated by a formula given in clause 6.2 of the Constitution. Growers will have a right to use their Plantation Area during the Term of the Project for the purpose of conducting their afforestation business.

32. If ITCPM does not have the land for the Plantation Units that a Grower has applied for, ITCPM will enter into an Agreement to enter into a Land Agreement with the Grower. This agreement will only be entered into if ITCPM can procure suitable land and provide Planting Services within 12 months of the Grower incurring the fees for these services. If the land is procured ITCPM will execute a Land Agreement on behalf of the Grower.

33. The Land Agreement incorporates the provisions of the Memorandum (Land Agreement Provisions). Some of the conditions of the Memorandum are that the Grower will:

- not use the Plantation Units for a purpose other than growing and harvesting trees;
- comply with sound silvicultural and environment practices adopted within the forestry industry; and
- comply with all laws and regulations relating to the use and occupancy of the Grower's Plantation Units.

Management Agreement

34. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the Agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultant and other specialist services as may be reasonably necessary. The provisions of the Memorandum (Management Agreement Provisions) are incorporated in the Management Agreement.

35. The services which ITCPM must perform are specified in Schedule 2 of the Memorandum. The services include the following:

Item 1 – Primary Services

- procure sufficient Trees to the specifications recommended in the Management Plan;

- prepare the land, in accordance with the Management Plan, for planting; and
- supervise and secure management of the works described above.

Item 2 – Planting Services

- plant Trees; and
- supervise and secure management of all works on the Plantation Area.

Item 3 – Forestry Services, include:

- manage the Tree Crop in accordance with the Management Plan;
- maintain adequate stocking of the Grower's Plantation Area by replacing any contiguous area of dead or missing trees;
- maintain the planting mounds by appropriate cultivation and weed control;
- maintain access roads and fire breaks and use all reasonable measures to keep the Plantation Area free from rabbits and other vermin; and
- report on the growth of the trees.

Item 4 – Harvesting and Marketing Services, include

- prepare a Harvesting plan for the Tree Crop;
- use reasonable endeavours to arrange for the sale of the Tree Crop and enter into a purchase agreement as agent for the Grower.

36. ITCPM will complete the delivery of all Primary Services within 12 months of the date the Primary Services fee is incurred by the Grower. Similarly, Planting Services will be completed within 12 months of the date the Planting Services fee is incurred by the Grower. Annual Services will be completed by 30 June of each year throughout the term of the Project.

Fees

37. The following amounts are payable to ITCPM for each Plantation Unit:

- **Primary Services Fee** of $2,200 payable on or before the date of execution of the Management Agreement (Item 1 of Schedule 3 to the Management Agreement Memorandum);

- **Planting Services Fee** of $220 payable on 31 October 2003 or on execution of the Management Agreement, whichever is the later (Item 1 of Schedule 3 to the Management Agreement Memorandum);
- **Forestry Services Fee** equal to 13.2% of the Harvest Proceeds, deducted from these proceeds (Item 2 of Schedule 3 to the Management Agreement Memorandum);
- **Land Fee** equal to 41.8% of the Harvest Proceeds, deducted from these proceeds (Schedule 2 to the Land Agreement Memorandum);
- **Harvesting Costs** equal to the Grower's proportion of the harvesting costs (clause 9.4 of the Management Agreement Memorandum);
- **Harvesting and Marketing Fee** equal to 5.5% of the Harvest Proceeds, deducted from these proceeds (Item 4 of Schedule 3 to the Management Agreement Memorandum).
- **Insurance** for Growers who enter into the Finance Package to insure their Plantation Units against loss or damage from 30 September in the year of planting, other Growers have the option to insure their Plantation Units from this date.

38. In addition to the above amounts, the following amount is payable by each Grower, regardless of the number of plantation units a Grower holds:

- **Primary Services Fee** of $1,100 payable on or before the date of execution of the Management Agreement (where the Grower participates in two or more of the Projects listed at paragraph 18, the additional sum will be payable only once by the Grower).

Option to pay Annual Fees in all or any years

39. A Grower can elect to pay an Annual Forestry Services and Annual Land Fee in respect of any or all of the Management Agreement Years or the equivalent Land Agreement Years. Such a payment or payments will reduce the Forestry Services Fee and Land Fees, described above, in accordance with a formula set out at Item 3 of Schedule 3 to the Management Agreement Memorandum and at Schedule 2 to the Land Agreement Memorandum.

40. The Annual Forestry Services Fee, if the Grower elects to pay it, in respect of any Management Agreement Year will be $110 per

Grower plus $77 per Plantation Unit (where the Grower participates in two or more of the Projects listed at paragraph 18, the sum of $110 is payable only for one of these Projects, in each year that the Grower elects to pay the Fee). The Annual Land Fee, if the Grower elects to pay it, in respect of any Land Agreement Year will be $220 per Plantation Unit.

41. If a Grower elects to pay an Annual Fee in any Management or Land Agreement year, both the Annual Forestry Services Fee and Annual Land Fee must be paid for that year. The Fees are payable on or prior to 31 May in the relevant Management or Land Agreement Year. From 1 July 2004, the fees will be adjusted to reflect movements in the Consumer Price Index (CPI).

Credit card merchant service fee

42. If the Responsible Entity provides facilities for Growers to pay any amount due in respect of the Project by credit card and the Responsible Entity incurs a merchant service fee or similar charge in connection with offering that facility, the Responsible Entity will be entitled to recover from the Grower the fee or charge, plus any GST applicable.

Planting

43. ITCPM will be responsible for planting trees on the Plantation Units. The species to be planted will generally be *Eucalyptus globulus* for Plantation Units located in Western Australia and the Green Triangle. *Eucalyptus grandis* and its hybrids will generally be planted on Plantation Units located in Queensland. A sufficient number of trees will be planted which would reasonably be expected to meet the projected timber production. Accordingly, the number of trees planted will vary between 700 and 1,000 per hectare depending on the assessed productivity of the land. Planting Services will be completed within 12 months of the date the Planting fee is incurred.

44. After planting, ITCPM will maintain the trees in accordance with good silvicultural practice. The Plantation Area will be replanted to maintain adequate stocking of the Plantation in accordance with the Management Plan by replacing any contiguous area of dead or missing trees. Thereafter, ITCPM will maintain the Plantation Area in accordance with good silvicultural practice.

Harvesting and Sale

45. Under clause 9.1 of the Management Agreement Memorandum the Grower may, within 12 months of the execution of

their agreement, elect itself to market and arrange for the sale of the Tree Crop, thereby becoming a 'Selling Grower', or ITCPM will use reasonable endeavours to sell the Tree Crop on the behalf of the 'Non-Selling Growers' (Item 4(d) of Schedule 2 to the Management Agreement Memorandum). This Ruling does not apply to Selling Growers.

46. A single harvest of all trees is expected to take place 10 years after planting. ITCPM will prepare a Harvesting plan and will manage the harvest in accordance with that plan. All Growers must pay their proportional share of the costs incurred by ITCPM in relation to the carrying out of the Harvesting (clause 9.4 of the Management Agreement Memorandum). In addition, ITCPM will be entitled to 5.5% of the Harvest Proceeds as a fee payable for Harvesting and Marketing Services.

47. The proceeds from the sale of timber of Non-Selling Growers will be paid direct to ITCPM who must deposit them into a Proceeds Fund (clause 3.3(c) of the Constitution). Each Grower will have a share in the Proceeds Fund which will be distributed among the Non-Selling Growers according to their Proportional Interest. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1 of the Constitution.

Finance

48. Growers can fund their initial fees either from:

- from their own financial resources;
- thorough finance offered by ITC Finance Pty Ltd (a lender associated with the Responsible Entity);
- through finance available through a Nominated Financier introduced by ITC Finance Pty Ltd; or
- borrow from an independent lender.

49. The finance offered by ITC Finance Pty Ltd is a 12 month interest free loan, repayable by monthly instalments. The Nominated Financier will offer interest bearing loans over either a 3, 5, 7 or 10 year term with monthly repayments of principal an interest. Both these offers will be made through the same document, entitled the 'Finance Package'.

50. Both ITC Finance Pty Ltd and the Nominated Financer will offer the finance on a full recourse basis. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

51. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' 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

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

- on or before 30 June 2003, where the Grower has executed a Land Agreement or an Agreement to enter into a Land Agreement and a Management Agreement on or before that date (2003 Growers); and/or
- on or after 1 July 2003 and before the expiry of the Prospectus, and where the Grower has executed a Land Agreement and a Management Agreement on or between those dates (2004 Growers).

53. The Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the project is accepted and the Project has commenced. This

Ruling does not apply to Growers who make an election to market timber produced from their Plantation Units (Selling Growers).

The Simplified Tax System ('STS')

Division 328

54. 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

55. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer' during the term of the Project. These are contingencies, relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

56. 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.

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

Deductions for Management fees and Land fees

Section 8-1

58. A Grower who is not an 'STS taxpayer' may claim tax deductions, for the revenue expenses set out in the following tables:

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Primary Services - fixed amount	8-1	See Notes (i), (ii) & (iii) below		
Primary Services - per Plantation Unit	8-1	$2,200 See Notes (i) & (ii) below		
Planting Services - per Plantation Unit	8-1		$220 See Notes (i) & (ii) below	
Annual Forestry Services Fee (if Grower elects to pay annually) - fixed amount	8-1		See Notes (i), (iii) & (iv) below	See Notes (i), (iii), & (iv) below
Annual Forestry Services Fee (if Grower elects to pay annually) - per Plantation Unit	8-1		$77 See Notes (i) & (iv) below	$77 (indexed) See Notes (i) & (iv) below
Annual Land Fees (if Grower elects to pay annually) - per Plantation Unit	8-1		$220 See Notes (i) & (iv) below	$220 (indexed) See Notes (i) & (iv) below

2004 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Primary Services – fixed amount	8-1	See Notes (i), (ii) & (iii) below		
Primary Services – per Plantation Unit	8-1	$2,200 See Notes (i) & (ii) below		
Planting Services – per Plantation Unit	8-1	$220 See Notes (i) & (ii) below		
Annual Forestry Services Fee (if Grower elects to pay annually) – fixed amount	8-1	See Notes (i), (iii) & (iv) below	See Notes (i), (iii) & (iv) below	See Notes (i), (iii) & (iv) below
Annual Forestry Services Fee (if Grower elects to pay annually) – per Plantation Unit	8-1	$77 See Notes (i) & (iv) below	$77 (indexed) See Notes (i) & (iv) below	$77 (indexed) See Notes (i) & (iv) below
Annual Land Fees (if Grower elects to pay annually) - per Plantation Unit	8-1	$220 See Notes (i) & (iv) below	$220 (indexed) See Notes (i) & (iv) Below	$220 (indexed) See Notes (i) & (iv) below

Notes:

If the Grower is registered or required to register for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example at paragraph 122.

Expenditure for Primary Services (fixed amount and per Plantation Unit) and Planting Services is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the income year in which it is incurred (see paragraphs 94 to 98 in the Explanations). If a 2003 Grower elects to pay the Planting Services Fee on application prior to 30 June 2003, that expenditure will be deductible in that year.

The fixed components of the Primary Services fee and the Annual Services fee, being amounts of $1,100 and $110 respectively, are deductible in full, however, if the Grower participates in two or more of the Projects listed at paragraph 18, they can only be incurred for one of these Projects. Therefore, if the Grower participates in two or more of the listed Projects, the fees can only be deducted for the Project for which they are incurred.

Where a Grower who is not an 'STS taxpayer', pays the Maintenance Fee and the Lease Fee in the relevant income years shown in the Management and Lease Agreement Memorandums, those fees are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

59. 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.

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

Deductions for Management fees and Land fees

Section 8-1 and section 328-105

61. A Grower who is an 'STS taxpayer' may claim tax deductions for the revenue expenses set out in the following tables:

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Primary Services - fixed amount	8-1 & 328-105	See Notes (v), (vi), (vii) & (viii) below		
Primary Services - per Plantation Unit	8-1 & 328-105	$2,200 See Notes (v), (vi), & (viii) below		
Planting Services - per Plantation Unit	8-1 & 328-105		$220 See Notes (v), (vi) & (viii) below	
Annual Forestry Services Fee (if Grower elects to pay annually) - fixed amount	8-1 & 328-105		See Notes (v), (vii), (viii) & (ix) below	See Notes (v), (vii), (viii) & (ix) below
Annual Forestry Services Fee (if Grower elects to pay annually) - per Plantation Unit	8-1 & 328-105		$77 See Notes (v), (viii) & (ix) below	$77 (indexed) See Notes (v), (viii) & (ix) below
Annual Land Fees (if Grower elects to pay annually) - per Plantation Unit	8-1 & 328-105		$220 See Notes (v), (viii) & (ix) below	$220 (indexed) See Notes (v), (viii) & (ix) below

2004 Growers

Fee Type	ITAA 1997 Section	Year ending 30/6/2004	Year ending 30/6/2005	Year ending 30/6/2006
Primary Services – fixed amount	8-1 & 328-105	See Notes (v), (vi), (vii) & (viii) below		
Primary Services – per Plantation Unit	8-1 & 328-105	$2,200 See Notes (v), (vi), & (viii) below		
Planting Services – per Plantation Unit	8-1 & 328-105	$220 See Notes (v), (vi) & (viii) below		
Annual Forestry Services Fee (if Grower elects to pay annually) - fixed amount	8-1 & 328-105	See Notes (v), (vii), (viii) & (ix) below	See Notes (v), (vii), (viii) & (ix) below	See Notes (v), (vii), (viii) & (ix) below
Annual Forestry Services Fee (if Grower elects to pay annually) – per Plantation Unit	8-1 & 328-105	$77 See Notes (v), (viii) & (ix) below	$77 (indexed) See Notes (v), (viii) & (ix) below	$77 (indexed) See Notes (v), (viii) & (ix)below
Annual Land Fees (if Grower elects to pay annually) - per Plantation Unit	8-1 & 328-105	$220 See Notes (v), (viii) & (ix) below	$220 (indexed) See Notes (v), (viii) & (ix) below	$220 (indexed) See Notes (v), (viii) & (ix) below

Notes:

If the Grower is registered or required to register for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example at paragraph 122.

Expenditure for Primary Services (fixed amount and per Plantation Unit) and Planting Services is expenditure for ‘seasonally dependent agronomic activities’ and is deductible in the income year in which it is incurred (see paragraphs 94 to 98 in the Explanations). If a 2003 Grower elects to pay the Planting Services Fee on application prior to 30 June 2003, that expenditure will be deductible in that year.

The fixed components of the Primary Services fee and the Annual Services fee, being amounts of $1,100 and $110 respectively, are deductible in full, however, if the Grower participates in two or more of the Projects listed at paragraph 18, they can only be incurred for one of these Projects. Therefore, if the Grower participates in two or more of the listed Projects, the fees can only be deducted for the Project for which they are incurred.

If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Where a Grower who is an 'STS taxpayer' pays the Forestry Services Fee and Land Fee in the relevant income years shown in the Management and Lease Agreement Memorandums, 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 management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 86 to 98). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Tax outcomes that apply to all Growers

Interest deductibility

62. 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 86 to 98 (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

63. For a Non-Selling Grower who is an individual and who enters the Project during the years ended 30 June 2003 or 30 June 2004, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the **income years ending 30 June 2003 to 30 June 2012** that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling (see paragraph 116).

64. 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 109 in the Explanations part of this ruling, below); or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

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

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

Section 82KL and Part IVA

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

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

68. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's activities as a participant in the ITC Pulpwood Project 2003 must amount to the carrying on of a business of primary production.

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

70. For schemes such as that of the ITC Pulpwood Project 2003, *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.

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

- the Grower has an identifiable interest in the land (by lease) or holds rights over the land (by licence) 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 an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

72. In this Project each Grower enters into a Land Agreement (which incorporates the Land Agreement Memorandum) and a Management Agreement (which incorporates the Management Agreement Memorandum).

73. Under the Land Agreement, each individual Grower will have rights over a specific and identifiable area of land. The Agreement provides the Grower with an ongoing interest in the specific trees on the Plantation Area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Agreement allows the Responsible Entity to come onto to the land to carry out its obligations.

74. Under the Management Agreement, the Responsible Entity is engaged by the Grower to establish and maintain the Grower’s identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Plantation Area on the Grower behalf.

75. The Responsible Entity may also be engaged to harvest and sell, on the Grower behalf, the wood produce grown on the Grower’s Plantation Area.

76. 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.

77. 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 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.

78. The pooling of produce grown on the Grower’s Plantation Area with the produce of other Growers is consistent with general afforestation practices. Each Grower’s proportionate share of the sale proceeds of the pooled produce will reflect the proportion of the trees contributed from their Plantation Area.

79. The Responsible Entity's services are also consistent with general afforestation practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a single Plantation Unit is relatively small, it is of a size and scale to allow it to be commercially viable.

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

81. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the ITC Pulpwood Project 2003 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

82. 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.

83. 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 Project fees

Section 8-1

84. Consideration of whether the Primary Services Fee, Planting Services Fee, Land Fee and other fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;

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

85. The Primary Services Fees, Planting Services Fee, Annual Forestry Fee, Annual Land Fee and Harvesting Costs will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber 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 management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayments provisions

Sections 82KZL to 82KZMG

86. 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.

87. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

88. 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 paragraph 92 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)).

89. 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 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.

90. 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.

91. 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.

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

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

93. 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

94. 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).

95. 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.

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

- it must be an agreement for planting and tending trees for felling; and

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

97. 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.

98. 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

99. Under the Management Agreement Memorandum, a Grower incurs a first year fee for Primary Services and a second year fee for Planting Services. These fees consist of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the expenditure is incurred.

100. Where Growers elect to pay an Annual Land Fee and Annual Forestry Services Fee, in accordance with the Land Agreement Memorandum and Management Agreement Memorandum, these fees are not prepaid. These fees are charged for lease, planting and maintenance services until 30 June of the year in which the fees are incurred. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can

claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

Growers who <u>choose</u> to pay fees for a period in excess of that required by the Project's agreements

101. Although not required under either the Land Agreement Memorandum or Management Agreement Memorandum, a Grower participating in the Project may **<u>choose</u>** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 100 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

102. For these Growers, the amount and timing of deductions for any relevant prepaid Annual Land Fees or prepaid Annual Forestry Services Fees, will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

103. However, as noted above, prepaid fees of less than $1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Interest deductibility

104. The deductibility of interest incurred by Growers who finance their participation through the Nominated Financier introduced by ITC Finance Pty Ltd or through another financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

105. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements <u>may</u> require interest to be prepaid. Alternatively, a Grower may <u>choose</u> to prepay such interest. Unless such prepaid interest is 'excluded expenditure', any tax deduction that is allowable will be subject to the relevant prepayments provisions of the ITAA 1936 (see paragraphs 86 to 98).

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

106. 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.

107. 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.

108. 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.

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

110. In broad terms, the four tests mentioned in paragraph 106 require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

111. 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 Non-Selling Grower who acquires the minimum allocation in the Project of two Plantation Units during the years ended 30 June 2003 or 30 June 2004, is unlikely to have their activity pass one of the tests until the year ended 30 June 2013.

112. Therefore, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

113. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years:

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

(ii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

114. Information provided with this Product Ruling indicates that a Non-Selling Grower who acquires the minimum allocation of two Plantation Units in the Project is expected to be carrying on a business activity that will produce a taxation profit for the income year ended 30 June 2013.

115. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2012.

116. This Product Ruling is issued on a prospective basis (i.e. before an individual Grower's business activity starts to be carried on). The Project, however may fail to be carried on during the income years specified above (see paragraph 63), in the manner described in the Arrangement (see paragraphs 14 to 51). If so, this Ruling, and specifically the decision in relation to subsection 35-55(1), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) applies, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings how subsection 35-55(1) will apply in such changed circumstances.

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

- the report of the Independent Forester, and additional evidence provided with the application by the Responsible Entity; and
- 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.

Section 82KL

118. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

119. For Part IVA to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C of the ITAA 1936); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

120. The ITC Pulpwood Project 2003 will be a ‘scheme’ commencing with the issue of the Prospectus. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 58 to 61 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Example - Entitlement to GST input tax credits

122. 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 2002, 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 1/1/2003 to 30/6/2003	$4,400*
Carrying out of upgrade of power for your vineyard as quoted	$2,200*
Total due and payable by 1 January 2003 (includes GST of $600)	$6,600

*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 2003, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as $4,000 (not $4,400).

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

Detailed contents list

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

Commissioner of Taxation
9 April 2003

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
- ITAA 1936 82KZMG(5)
- ITAA 1936 Pt IVA
- ITAA 1936 Div Pt III
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
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