



# ***PR 2003/13 - Income tax: Wholesale Forestry***

 This cover sheet is provided for information only. It does not form part of *PR 2003/13 - Income tax: Wholesale Forestry*

 This document has changed over time. This is a consolidated version of the ruling which was published on *16 April 2003*



## **Product Ruling**

### **Income tax: Wholesale Forestry**

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Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	44
Explanations	65
Examples	125
Detailed contents list	126

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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**

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

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how 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**

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

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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 Wholesale Forestry Project or simply as 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Section 8-1 (ITAA 1997);
  - Section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - Division 35 (ITAA 1997);
  - Part 3-1 (ITAA 1997);
  - Division 328 (ITAA 1997);
  - Section 44 of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - Section 82KL (ITAA 1936);
  - Section 82KZL (ITAA 1936);
  - Section 82KZME (ITAA 1936);
  - Section 82KZMF (ITAA 1936);
  - Section 82KZMG (ITAA 1936); and
  - Part IVA (ITAA 1936).

### Goods and Services Tax

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

**Changes in the Law**

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

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

**Note to promoters and advisers**

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

**Class of persons**

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e. being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling each of these persons, referred to as 'Growers' will be wholesale clients for the purpose of the *Corporations Act 2001*.

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. The class of persons to whom this Ruling applies does not include Growers who elect to sell their own timber.

## Qualifications

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

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## Date of effect

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11. This Ruling applies prospectively from 16 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 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

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal,

who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

## **Arrangement**

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

- Application for Product Ruling dated 12 February 2003 and additional correspondence dated 18 February 2003, 25 February 2003, 7 March 2003, 19 March 2003, 20 March 2003, 27 March 2003, 2 April 2003 and 3 April 2003;
- Draft Information Memorandum undated;
- Draft **Lease and Sub Lease Agreement** between KI Plantations Ltd [the 'Lessor'] and the Grower, dated 23 December 2002;
- Draft **Management Agreement** between the Grower and WRF Forestry Pty Ltd [the 'Manager'], undated;
- Inspection Reports from the Independent Forester dated 14 July 2000, 17 October 2000, 13 November 2000, and 10 March 2001.

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

15. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

17. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client. **This Ruling does not apply unless** the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*.

18. The meaning of a wholesale client is explained in paragraphs 65 to 70 in the Explanations area of this Product Ruling.

**PR 2003/13****Overview**

19. The salient features of the Wholesale Forestry Project are as follows.

Location	Kangaroo Island in South Australia
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Eucalyptus globulus</i> (Tasmanian Blue Gums) trees for the purpose of producing timber for wood chipping.
Number of hectares to be under cultivation	2,000 hectares
Minimum subscription per Grower	15 Forestry Units and 15 Share Parcels
Size of each Forestry Unit	1 hectare
Number of trees per hectare	1,000
The term of the Project (financial years)	Approximately 10 years
Initial cost per Forestry Unit	\$2,203.30 plus \$1,425 for shares in KI Plantations Ltd.
Initial cost per hectare	\$2,203.30 plus \$1,425 for shares in KI Plantations Ltd
Ongoing costs	Annual Management fee (including Rent)
Other Costs	Timber Production Costs Co-ordination fee

20. This Project is a Managed Investment Scheme offered to wholesale clients as defined in the *Corporations Act 2001*. The Wholesale Forestry Project is a silvicultural Project to cultivate and harvest *Eucalyptus globulus* (Tasmanian Blue Gums) for wood chipping. The Project is for a period of approximately 10 years.

21. The Wholesale Forestry Information Memorandum is issued by WRF Capital Ltd. WRF Capital Ltd has appointed WRF Forestry Pty Ltd to be the manager of the Project. WRF Forestry Pty Ltd and WRF Capital Ltd are wholly owned by WRF Securities Ltd.

22. The Project land is situated on Kangaroo Island in South Australia. KI Plantations Ltd (the 'Lessor') owns part of the Project land and holds crown leases over the remaining Project land. The Lessor will lease or sub-lease the land to the Grower to enable the

Grower to carry on the business of afforestation for the commercial production of wood produce.

23. Growers participating in this Project will enter into a Management Agreement and a Lease and Sub-Lease Agreement. Under the Lease and Sub-Lease Agreement, Growers lease or sub-lease an identifiable area of land called a Forestry Unit. For the purposes of this Ruling, Growers whose Lease and Sub-Lease and Management Agreements are executed by 30 June 2003 are referred to as '2003 Growers'. Growers whose Lease and Sub-Lease and Management Agreements are executed between 1 July 2003 and 30 June 2004 are referred to as '2004 Growers'. WRF Securities Ltd owns 100% of the voting shares in KI Plantations Ltd.

24. Under the Information Memorandum, the Minimum Application for each Grower is 15 Forestry Units. For each Forestry Unit, Growers must also subscribe for one Share Parcel of 1,425 non voting ordinary shares in KI Plantations Ltd. The maximum number of Forestry Units and Share Parcels to be offered under this Project is 2,000 Forestry Units and 2,000 Share Parcels. Each Forestry Unit is one hectare in size and will be planted with approximately 1,000 trees per hectare.

25. Each Share Parcel costs \$1,425 (\$1 per share) plus stamp duty of \$9. Growers may elect to pay for the shares under either Option A or Option B. Under Option A, the purchase price is payable in two instalments, being \$75 on 1 July 2003 and \$1,425 on 31 December 2003, which includes interest of \$75. Under Option B the purchase price is payable annually in four instalments, which includes interest of \$285. In respect of the four instalments, \$142.50 is payable on 1 July 2003, \$570 on 1 July 2004, \$522.50 on 1 July 2005 and \$475 on 1 July 2006.

26. The executed Application for Forestry Units appoints WRF Capital Ltd to act as agent to enter into the Management and Lease and Sub-Lease Agreement on behalf of the Grower. The allotment and issue of Forestry Units will take place within 60 days of the receipt of the completed Application and the clearance of the Application payment. Application payments and annual payments will be banked into the trust account of WRF Capital Ltd. WRF Capital Ltd will disburse funds from its trust account in accordance with its contractual obligations.

### **Lease and Sub-Lease Agreement**

27. Growers participating in the arrangement will enter into a Lease and Sub-Lease Agreement with KI Plantations Ltd (the 'Lessor'). Growers are granted an interest in land in the form of a lease or sub-lease to use their Forestry Units for the purpose of



conducting their afforestation business. (clause 2.1). The term of the Lease or Sub-Lease is for a period of the earlier of 13 years or the completion of the harvest of all trees, sale of the timber and the distribution of net proceeds.

28. Under the Lease and Sub-Lease Agreement annual rent of \$27.50 per Forestry Unit is payable by the Grower to the Lessor. The annual rent is included in the initial amount payable on Application and the Management Fees payable annually by the Grower to the Manager. The Manager will remit the rent to the Lessor on behalf of the Grower (cl 5.12(p) of the Management Agreement). The rent is indexed annually from 1 July 2004 for 2003 Growers and 1 July 2005 for 2004 Growers by the increase in the consumer price index or the rate of 3% whichever is the greater.

## Management Agreement

29. Under the Management Agreement, the Grower engages WRF Forestry Pty Ltd to carry out duties to plant, manage, maintain, harvest and if applicable, mill the timber from the trees on the Forestry Units, in accordance with the Forestry Management Plan. The Forestry Management Plan (Part 3 of the Schedule to the Management Agreement) specifies the services to be performed by the Manager. The Manager will carry out all obligations of the Grower under the Lease and Sub-Lease Agreement, including the Grower's obligation to pay the Rent to the Lessor. The charge for the Rent is incorporated in the Management Fee.

30. Growers may elect, by notice in writing to the Manager before 30 June 2004, to sell the timber harvested from their Forestry Units (cl 8.5).

31. The Manager will perform the following services within 12 months of the commencement date;

- prepare and grade the Forestry Units for the Planting of Trees (including the application of pesticides and fertilisers where necessary);
- select on behalf of the Grower, trees, which are to the best of the Manager's knowledge are high yielding *Eucalyptus globulus* trees; and
- plant an average of not less than one thousand trees per Forestry Unit.

32. The Manager will perform the following ongoing services under the Agreement:

- manage, maintain and cultivate the Forestry Units, including growing, selecting, procuring and applying

appropriate fertilisers, nutrients, and herbicides and doing all other things reasonable necessary for the purpose of maintaining and cultivating the Forestry Units in accordance with good and proper silvicultural practices;

- procure the use of all necessary plant, equipment, machinery, goods and material for the purposes of performing the management services and any other necessary fixtures required for the purpose of performing the management services;
- keep each Forestry Unit free of competitive weeds, vermin, noxious animals and insects;
- replace any Trees that die during the three months following the planting of the Trees such that an average of one thousand trees are growing on the Forestry Units at that time; and
- harvest, remove, mill, market and sell the Trees on behalf of the Grower (unless the Grower has elected to sell their own timber).

33. The Manager will perform coordination of harvesting services for all Growers for a fee of 3.5% of the Net Sale Proceeds of all the Forest Product harvested. The Manager will pay for the cost of public liability insurance on the Forestry Units. Any additional insurance required by the Grower must be borne by the Grower.

34. The Management Agreement commences from the date of Allotment until the completion of the harvest, the sale of all Timber and the receipt and dealing with all proceeds, or the termination of the Lease and Sub-Lease, whichever is the latest.

### **Planting**

35. The Manager is required to plant an average of not less than 1,000 *Eucalyptus globulus* trees per Forestry Unit within 12 months after Allotment. Thereafter, the Manager will manage, maintain and cultivate the Forestry Units in accordance with good and proper silvicultural practices. The services to be provided by the Manager over the term of the Project are outlined in Forestry Management Plan (Part 3 of the Schedule to the Management Agreement).

# PR 2003/13

## Harvesting

36. The Manager will conduct one Harvest only in approximately 10 years from the date of Allotment of the Forestry Units. The Manager will decide when it is appropriate to Harvest having regard to sound forestry practice. Within 3 months of the Harvest, the Manager shall provide a plan of Harvest setting out the Harvesting dates and a Harvesting Quote which details the Harvesting costs, delivery costs and milling costs (if applicable). Unless the Grower elects to sell their timber or objects to the Harvesting Quote within 60 days, the Manager will harvest and mill the timber in accordance with the Harvest Quote. The Timber Production Costs include the Harvest Fee and additional transportation, drying and delivery costs. These costs will be deducted from the Gross Sale proceeds. All Growers must also pay a Co-ordination Fee of 3.5% of the Net Sale Proceeds.

## Fees

37. The Grower will make the following payments per Forestry Unit.

38. An initial fee of \$2,203.30 is payable on Application to the Manager, which consists of an Establishment Fee of \$2,175.80 for expenditure incurred in preparing and grading the Forestry Units for the planting of the trees and \$27.50 for rent. The services in respect of the Establishment Fee will be carried out within 12 months from the commencement date.

39. An annual Management Fee is payable in advance on 1 July next following the date of Allotment of the Forestry Units. The Management Fee for the period 1 July 2003 to 30 June 2004, for 2003 Growers or 1 July 2004 to 30 June 2005 for 2004 Growers is \$630.30. The Management Fee for the income year ended 30 June 2005 and 30 June 2006 for 2003 Growers or 30 June 2006 to 30 June 2007 for 2004 Growers is \$245.30 and \$177.10 respectively. These Management Fees include rent of \$27.50 which will be indexed from 1 July 2004 for 2003 Growers or 1 July 2005 for 2004 Growers. The Management Fee incorporates an inflation rate of 2.28%. The Manager is entitled to adjust the Management Fee if the annual inflation rate exceeds 2.28%. The Manager is also entitled to invoice the Grower if the Manager is required to conduct work which the Manager considers is abnormal in nature.

40. The Manager has prepared an annual plan of work to be carried out on the Plantation as a whole. The plan of work has been costed based on best estimates for a period of 10 years from the planting of the trees to the completion of the Project. If the Manager is able to achieve cost savings in the carrying out of the annual plan of

work for the Plantation as a whole in any one year, then 60% of those savings will be paid to the Growers. The Manager will use its best endeavours to pay this amount by 31 January of the following financial year (cl 4.4 of the Management Agreement).

41. A Co-ordination fee of 3.5% of the Net Sale Proceeds is required to be paid by all Growers. In addition, Timber Production Costs are payable by the Grower.

### **Finance**

42. All Growers fund their investment in the Project themselves.

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

## Ruling

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### Application of this Ruling

44. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 June 2004 and who have executed Management Agreements and Lease and Sub-Lease Agreements before that date. 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.

45. This Ruling does not apply to those Growers who make an election under the Management Agreement to take delivery of and sell the timber produced from their Forestry Unit(s).

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

#### *Division 328*

46. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, 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

47. 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 '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***

48. 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.

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

***Cost Savings***

50. The payment of any cost savings of the Manager to a Grower (see paragraph 40 above) less any GST payable on those proceeds, is income according to ordinary concepts and is assessable under section 6-5 at the time the income is derived.

**Deductions for the Establishment Fee and Management Fee*****Section 8-1***

51. A Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses for each Forestry Unit held:

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee – seasonally dependent agronomic activities</b>	8-1	\$2,175.80 – See Notes (i) & (ii) (below)		
<b>Rent (for the Year ended 30 June 2003)</b>	8-1	\$27.50 – See Note (i) (below)		
<b>Management fee (including Rent for the Year ended 30 June 2004 onwards)</b>	8-1		\$630.30 – See Notes (i) & (iii) (below)	\$245.30 – See Notes (i)& (iii) (below)

**2004 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year Ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee – seasonally dependent agronomic activities</b>	8-1	Nil	\$2,175.50 – See Notes (i) & (ii) (below)	
<b>Rent (for the Year ended 30 June 2004)</b>	8-1	Nil	\$27.50 – See Note (i) (below)	
<b>Management fee (including Rent for the Year ended 30 June 2005 onwards)</b>	8-1	Nil		\$630.30 – See Notes (i) & (iii) (below)

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 125.
- (ii) Expenditure for ‘seasonally dependent agronomic activities’ is deductible in the income year in which it is incurred.
- (iii) Where a Grower who is not an ‘STS taxpayer’, pays the management fee in the relevant income years shown in the Lease and Sub-Lease Agreement and Management Agreement, 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 95 unless the expenditure is ‘excluded expenditure’. However, as the minimum subscription per Grower is 15 Forestry Units, the management fees will not qualify as ‘excluded expenditure’.

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

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

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

***Cost Savings***

54. The payment of any cost savings of the Manager to a Grower (see paragraph 40 above) less any GST payable on those proceeds, is income according to ordinary concepts and is assessable under section 6-5 at the time the income is received.

**Deductions for Establishment Fee and Management Fee*****Section 8-1 and section 328-105***

55. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee – seasonally dependent agronomic activities</b>	8-1 & 328-105	\$2,175.80 – See Notes (iv), (v) & (vi) (below)		
<b>Rent (for the Year ended 30 June 2003)</b>	8-1 & 328-105	\$27.50 – See Notes (iv) & (v) (below)		
<b>Management Fee (including rent for the Year ended 30 June 2004 onwards)</b>	8-1 & 328-105		\$630.30 – See Notes (iv), (v) & (vii) (below)	\$245.30 – See Notes (iv), (v) & (vii) (below)



**PR 2003/13****2004 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year Ended 30/6/2003</b>	<b>Year ended 30/6/2004</b>	<b>Year ended 30/6/2005</b>
<b>Establishment Fee – seasonally dependent agronomic activities</b>	8-1 & 328-105	Nil	\$2,175.80 – See Notes (iv), (v) & (vi) (below)	
<b>Rent (for the Year ended 30 June 2003)</b>	8-1 & 328-105	Nil	\$27.50 – See Notes (iv) & (v) (below)	
<b>Management Fee (including Rent for the Year ended 30 June 2005 onwards)</b>	8-1 & 328-105	Nil		\$630.30 – See Notes (iv), (v) & (vii) (below)

**Notes:**

- (iv) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 125.
- (v) 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.
- (vi) Expenditure for 'seasonally dependent agronomic activities' is deductible in the income year in which it is incurred.
- (vii) Where a Grower who is an 'STS taxpayer', pays the management fees in the relevant income years shown in the Lease and Sub-Lease Agreement and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion

those fees (see paragraphs 89 to 96). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 95, unless the expenditure is 'excluded expenditure'. However, as the minimum subscription per Grower is 15 Forestry Units, the management fees will not qualify as 'excluded expenditure'.

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

#### ***Interest***

56. 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 89 to 96 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Growers choice.

#### ***Shares***

57. The shares in KI Plantations Ltd are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

58. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

#### ***Dividends relating to the shares***

59. Dividends paid out of profits by KI Plantations Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

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

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

60. For a Grower who is an individual and who enters the Project during the year 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 for 2003 Growers, and 30 June 2004 to 30 June 2012 for 2004 Growers, 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.

61. 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 112 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)).

62. 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.

63. 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***

64. For a Grower who participates in the Project and incurs expenditure as required by the Lease and Sub-Lease and Management Agreements 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.

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**Explanations****Corporations Act 2001**

65. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by a Grower who qualifies as a wholesale client as defined in section 761G of the *Corporations Act 2001*.

66. Offers to wholesale clients do not require a prospectus or product disclosure statement.

67. A Grower in the Project will be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the person satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); and
- the 'professional investor test' (paragraph 761G (7)(d)).

68. A participant in a managed investment scheme, referred to below as the 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where:

- the minimum amount payable for the interest in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interest in the project of the same class that are held by the person add up to at least \$500,000.

69. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the individual wealth test where it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

70. A participant in a managed investment scheme referred to below as 'the person' or 'the person to whom the offer is made' will satisfy the 'professional investor' test where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

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

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

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

73. For schemes such as that of Wholesale Forestry, 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; (1984) 16 ATR 932.

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

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber produce from those trees;

- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

75. In this Project, each Grower enters into a Lease and Sub-Lease and Management Agreement.

76. Under the Lease and Sub-Lease Agreement each individual Grower will have rights over a specific and identifiable area consisting of one hectare of land. The Lease and Sub-Lease Agreement provides the Grower with an ongoing interest in the specific trees on the Forestry Units. Under the lease or sub-lease the Grower must use the land in question for the purpose of carrying out afforestation activities and for no other purpose. The lease or sub-lease allows the Manager to come onto the land to carry out its obligations under the Lease and Sub-Lease Agreement.

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

78. The Manager is also engaged to harvest and sell, on the Grower's behalf, the timber produce grown on the Grower's Forestry Unit unless the Grower has elected to sell their own produce under the Management Agreement.

79. 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.

80. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the timber 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.

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

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

83. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Forestry Unit and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

84. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in Wholesale Forestry will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

85. 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.

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

## **Deductibility of the Establishment Fee and Management Fee**

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

87. Consideration of whether the Establishment Fee and Management Fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and

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

88. The Establishment Fee and Management Fee 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 fee appears to be reasonable. There is no capital component in the establishment fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Prepayment provisions**

#### ***Sections 82KZL to 82KZMF***

89. 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.

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



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

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

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

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

93. 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.

94. 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.

95. 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.

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

96. 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***

97. Under subsection 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).

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

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

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

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

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

100. 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.

101. 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***

102. Under the Management Agreement, a Grower incurs an Establishment Fee consisting of expenditure of \$2,175.80 for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2003 for 2003 Growers or 30 June 2004 for 2004 Growers, for the Establishment Fee incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

103. The Management Agreement also requires that a Grower incurs a Management Fee per year for the performance of management services during the term of the Project.

104. The fees under the Management Agreement are not prepaid. These fees are charged for providing management services until 30 June of the year in which the fees are incurred.

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

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

106. Although not required under either the Lease and Sub-Lease or Management Agreements, a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 105 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

108. 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.

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

109. 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 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.

110. 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.

111. 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.

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

113. 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).

114. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of 15 Forestry Units in the Project is unlikely to ever pass one of the tests.

115. 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.

116. 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.

117. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of 15 Forestry Units 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 2013.

118. 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.

119. 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 60) in the manner described in the Arrangement (see paragraphs 14 to 43). If so, this Ruling, and specifically the decision in relation to paragraph 35-55 (1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

120. 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 expert or scientific evidence provided with the application by the Manager; 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 Manager.

### ***Section 82KL - recouped expenditure***

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

***Part IVA - general tax avoidance provisions***

122. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

123. Wholesale Forestry will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 51 and 55 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

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

125. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her afforestation business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (includes GST of \$600)	<u>\$6,600</u>

\*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 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**

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

	Paragraph
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
Overview	19
Lease and Sub-Lease Agreement	27
Management Agreement	29



**PR 2003/13**

Planting	35
Harvesting	36
Fees	37
Finance	42
<b>Ruling</b>	<b>44</b>
Application of this Ruling	44
The Simplified Tax System ('STS')	46
<i>Division 328</i>	46
Qualification	47
Tax outcomes for Growers who are not 'STS taxpayer's'	48
<i>Assessable income</i>	48
<i>Section 6-5</i>	48
<i>Cost Savings</i>	50
Deductions for the Establishment Fee and Management Fee	51
<i>Section 8-1</i>	51
Tax outcomes for Growers who are 'STS taxpayers'	52
<i>Assessable Income</i>	52
<i>Section 6-5 and section 328-105</i>	52
<i>Cost Savings</i>	54
Deductions for the Establishment Fee and Management Fee	55
<i>Section 8-1 and section 328-105</i>	55
Tax outcomes that apply to all Growers	56
<i>Interest</i>	56
<i>Shares</i>	57
<i>Dividends Relating to the shares</i>	59
Division 35 - Deferral of losses from non-commercial business activities	60
<i>Section 35-55 - Commissioner's discretion</i>	60
<i>Section 82KL and Part IVA</i>	64
<b>Explanations</b>	<b>65</b>
Corporations Act 2001	65
Is the Grower carrying on a business?	71
The Simplified Tax System	85

<i>Division 328</i>	85
Deductibility of the Establishment Fee and Management Fee	87
<i>Section 8-1</i>	87
Prepayments provisions	89
<i>Sections 82KZL to 82KZMF</i>	89
<i>Sections 82KZME to 82KZMF</i>	91
<i>Section 82KZMG</i>	97
<i>Application of the prepayment provisions to this Project</i>	102
<i>Growers who <u>choose</u> to pay fees in excess of that required by the Project's agreements</i>	106
Deferral of losses from non-commercial business activities	109
<i>Division 35</i>	109
<i>Section 82KL - recouped expenditure</i>	121
<i>Part IVA - general tax avoidance provisions</i>	122
<b>Examples</b>	<b>125</b>
Example 1 - Entitlement to GST input tax credits	125
<b>Detailed contents list</b>	<b>126</b>

**Commissioner of Taxation**

16 April 2003

*Previous draft:*

Not previously issued in draft form

- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

*Related Rulings/Determinations*

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

*Legislative references*

- TAA 1953 Pt IVA
- ITAA 1997 Pt 3-1
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35

*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

- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
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- ITAA 1997 108-5
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)
- ITAA 1936 44(1)
- ITAA 1936 82KL
- ITAA 1936 82KZL
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- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
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