



# ***PR 2003/37 - Income tax: W.A. Blue Gum Project 2003***

 This cover sheet is provided for information only. It does not form part of *PR 2003/37 - Income tax: W.A. Blue Gum Project 2003*

 This document has changed over time. This is a consolidated version of the ruling which was published on *7 December 2005*



## Product Ruling

### Income tax: W.A. Blue Gum Project 2003

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

#### *Preamble*

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **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**

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

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

#### **Terms of use of this Product Ruling**

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

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## What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the W.A. Blue Gum Project 2003 or simply '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);
  - Section 25-20 (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

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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 harvest and 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.

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## Date of effect

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11. This Ruling applies prospectively from 4 June 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 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 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 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:

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- Application for a Product Ruling dated 27 March 2003 as constituted by documents provided 17 March 2003, 27 March 2003, 15 April 2003, 13 May 2003, 20 May 2003, 21 May 2003, 22 May 2003 and 26 May 2003 and additional correspondence and e-mails dated 7 May 2003, 13 May 2003, 16 May 2003 and 23 May 2003;
- Prospectus dated 17 April 2003 for the W.A. Blue Gum Project 2003 issued by W.A. Blue Gum Limited A.C.N. 060 179 982 ('WABG' or the 'Responsible Entity'), received by the Tax Office 13 May 2003;
- The draft **Constitution** establishing the W.A. Blue Gum Project ('the Constitution') received by the Tax Office 17 March 2003;
- The **Sub-lease (2003)**, to be entered into by each Grower and WABG ('the Landholder') received by the Tax Office 21 May 2003;
- The **Project Management Contract (2003)**, to be entered into by each Grower, WABG (the 'Project Manager') and URS Forestry Pty Ltd ('URS Forestry') received by the Tax Office 21 May 2003;
- The **Loan Agreement** which may be entered into by each Grower and Albany Financial Pty Ltd A.C.N. 060 326 409 ('Albany Financial') an entity associated with WABG received by the Tax Office 21 May 2003;
- The **Wood Purchase Agreement 2003**, to be entered into by each Grower, WABG ('the Authorised Vendor') and W.A. Chip & Pulp Co Pty Ltd A.C.N. 008 720 518 ('the Purchaser') received by the Tax Office 21 May 2003;
- The Plantation Services Agreement to be entered into between WABG and WACAP Treefarms Pty Ltd A.C.N. 009 378 607 ('the Contractor');
- The Scheme Property Custody Agreement between WABG and Sandhurst Trustees Limited A.C.N. 004 030 737 ('the Custodian') dated 12 April 2000; and
- The Compliance Plan for W.A. Blue Gum Project dated 11 December 2002.

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

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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. The effect of these agreements is summarised below.

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 W.A. Blue Gum Project 2003 arrangement are as follows:

Location	South West region of Western Australia.
Type of business each participant is carrying on	Commercial growing of <i>Eucalyptus globulus</i> (Tasmanian Blue Gum) for the purpose of producing timber for wood chipping.
Number of hectares under cultivation	The projected land area, which will be planted under this Prospectus, will be 416 hectares, which may be increased for oversubscriptions.
Size of Plantation Allotment	An allocation of a leased area of one hectare.
Minimum allocation per Grower	Six hectares.
Number of trees per hectare	1,000 – 1,250 trees.
The term of the Project	Approximately 10 years. The project will terminate when the plantation crop is harvested for the first time.
Initial cost per hectare	\$4,950 fee for Establishment Services.
Ongoing costs	Growers will pay a management fee of \$99 per hectare per annum increased by Consumer Price Index (CPI) and rent of \$396 per hectare per annum indexed by CPI.
Other costs	<ul style="list-style-type: none"> <li>• Harvesting, delivery and processing costs will be retained from the Purchase Price on a proportional basis of Grower's participation.</li> <li>• Fire insurance and stamp duty costs.</li> </ul>

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18. The Project is registered as a managed investment scheme under the *Corporations Act 2001*. The Project is to establish, manage and harvest *Eucalyptus globulus* (Tasmanian Blue Gum) for the purpose of woodchip.

19. Applicants will become 2003 or 2004 Growers depending on their date of application. Growers participating in the arrangement will enter into a Sub-lease, a Project Management Contract and a Wood Purchase Agreement. A Grower who borrows from Albany Financial will also enter into a Loan Agreement. Growers will become 2003 Growers where an application is accepted and these three documents are executed by 30 June 2003. Applications of Growers processed between a date on or after 1 July 2003 and on or before 26 March 2004, will commence participation as 2004 Growers.

20. The Sub-lease gives a Grower an interest in an identifiable area of land, the 'Leased Area'. Each Leased Area is made up of one hectare allotments. The minimum area of land that can be leased by a Grower under the Project is six hectares.

21. There is no minimum amount that must be raised under the Prospectus. The Project land is situated in the South West of Western Australia. The properties to be leased to Growers are within a radius of 100km from either the Port of Bunbury or Albany, as follows:

- 295 hectares part of Nelson locations 7008, 7009, 8885 and 8886, Lots 8868, 8869 and 8870 on Deposited Plan 201635, Lot 11147 on Deposited Plan 153407 and Lot 12148 on Deposited Plan 201624 (Smeathers property);
- 48 hectares part of Nelson location 12139 (Flanagan property); and
- 73 hectares part of Nelson location 11952 (Magenta property).

22. If the whole of this land is taken up, further land located in other parts of the South West of Western Australia will be leased, although this land may produce slightly lesser yields.

23. The Growers enter into a Project Management Contract with WABG ('the Project Manager') and URS Forestry which sets out the services to be provided by WABG, as Project Manager, in establishing and maintaining Tasmanian Blue Gum (*Eucalyptus globulus*) seedlings planted on the leased land for the purpose of eventual felling and sale. Under the Project Management Contract URS Forestry agrees to act as supervisor and adviser to the Project.

24. A Custodian has been appointed under the Scheme Property Custody Agreement to protect the interests of the Growers in their dealings with WABG.

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## **Constitution**

25. The Constitution establishes the Project and operates as a deed binding all of the Growers and WABG. The Constitution sets out the terms and conditions under which WABG 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. Pursuant to clause 9 of the Constitution, WABG will keep a register of Growers.

26. Under the terms of clause 6 of the Constitution, all moneys received from applications shall be paid to WABG. It shall open, or cause to be opened, an account designated Application Fund, into which all money received from Applicants and accrued interest will be deposited. If the application money is held in the Application Fund for more than 12 months, the money shall be refunded, along with any interest earned on it, to the Applicant, unless the Applicant directs WABG otherwise.

## **Scheme Property Custody Agreement**

27. WABG, as Responsible Entity, has engaged Sandhurst Trustees Ltd to act as Custodian of the Property, as defined at Item 1 of this Agreement. The Property includes all Application Moneys and timber sale proceeds until disbursed or distributed in accordance with the Constitution, the Project Agreements and the Head Lease.

## **Compliance plan**

28. As required by the *Corporations Act 2001*, WABG has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that WABG manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected. Compliance is monitored by a Compliance Committee.

## **Project Management Contract**

29. Under the Project Management Contract, Growers contract with the Project Manager to establish and maintain the plantation until maturity. Each Grower pays an Application Amount of \$4,950 per hectare for Establishment Services. These are defined to mean all seasonally dependent agronomic activities, including the application of fertilisers and herbicides, until the first planting of the Plantation Crop under clause 1.1.

30. The Grower pays an annual management fee of \$99, indexed after the first year for CPI (All Groups, Perth), per hectare of 'Plantable Area' for ongoing maintenance. The 'Plantable Area' is the

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area on which a eucalyptus plantation can be established, set out in Part 3 of the Schedule to this Contract.

31. The Project Manager provides services according to the Management Plan. The Project Manager will manage all silvicultural activities and must:

- establish the Plantation Crop (including the planting of *Eucalyptus globulus* seedlings on the land);
- maintain the plantation crop according to good silvicultural and forestry practices, in accordance with the Management Plan; and
- keep access roads in good repair and each block free from rabbits and other vermin (clause 4.1).

32. The Project Management Contract also provides for a second rotation plantation crop, through a coppice option. Growers who take up this option will be required to pay extra amounts at a future date and enter into arrangements to extend the effect of the Project agreements. This option may be taken up at the time of the harvest of the first plantation crop. **The arrangement to be ruled on in this Product Ruling does not include this coppice option.**

## Plantation Services Agreement

33. WABG (the 'Project Manager') and WACAP Treefarms Pty Ltd (the 'Contractor') enter into this Agreement.

34. The Contractor agrees to carry out the necessary plantation services to establish, tend and maintain a plantation of eucalyptus trees on the Land as set out in the Plantation Development and Maintenance Plan. The services will be in accordance with sound silvicultural and environmental practices adopted within the forestry industry.

## Sub-lease

35. Growers will enter into a Sub-lease of land with WABG ('the Landholder'). The term of the Sub-lease is 12 years or until the first harvesting of the trees upon the land.

36. Under this Sub-lease the Grower pays annual rent of \$396 per hectare of Plantable Area, indexed after the 1st year by the CPI, Perth. The Plantable Area is set out in Part 2 of the Schedule to the Sub-lease. The Grower is to establish, tend and harvest a plantation of eucalyptus trees for commercial wood production on the Plantable Area.

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37. If there is damage to or reduction in the viability of the crop, the Grower must have the Plantable Area reduced or can terminate the contract under Clause 10. The result of a reduction under this clause is that the Grower is deemed to have surrendered the land back to the Landholder & all obligations in relation to that land under the Sub-lease end. The Grower's share of the harvest proceeds will be proportionally reduced.

## **Wood Purchase Agreement.**

38. Growers authorise WABG ('the Authorised Vendor') to enter into the Wood Purchase Agreement with WACAP ('the Purchaser') on their behalf. Under the Agreement all Growers' timber is pooled together for sale to the Purchaser by the Authorised Vendor. The Purchaser harvests, delivers and purchases the timber, for a price they quote, provided it is accepted by the Authorised Vendor. The Authorised Vendor can harvest and deliver the wood under sub-clause 8.1 or, may obtain a quote less than the Purchaser's quote, and contract an 'External Contractor' to harvest the wood. The Authorised Vendor can negotiate a better sale price with a reputable third party. The Purchaser then has the right to match these better terms, in which case it will be the buyer.

## **Fees**

39. Under the Project Management Contract, the Sub-lease and the Wood Purchase Agreement a Grower will pay the following fees per hectare:

- the Application Amount payable under the Project Management Contract of \$4,950 per hectare of Leased Area for the establishment of the Plantation Crop within 12 months of the Application;
- a management fee of \$99 per hectare indexed from 30 June 2003 is payable on or before 28 February each year for services to be provided between 1 July and 30 June of that financial year. The initial financial year commences on 1 July 2003;
- 15% of the amount by which the net proceeds exceed the sum of \$10,000 per hectare (indexed from 30 June 2003);
- unforeseen expenses in relation to fertiliser and/or insect issues, borne between the Growers in proportion to the number of hectares held by each Grower. The Growers vote to meet such expenses, at a meeting convened by WABG;

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- rent of \$396 per hectare per annum indexed. The first rent is payable on 15 November 2003 in respect of the period from 1 July 2003 until 30 June 2004. Subsequently it is payable annually on 30 September; and
- harvest and delivery fees, for services provided according to the Harvest Plan.

## **Finance**

40. Growers can fund their involvement in the Project by borrowing from Albany Financial (a lender associated with WABG), or borrow from an independent lender.

41. Growers are able to borrow from Albany Financial an amount up to 80% of the Application Amount. The terms of the finance are, as follows:

- a term ending on 30 September 2007, with repayments of principal and interest twice each year; and
- a fixed interest rate of 8.9% per annum.

42. The security for the loan is provided by the assignment to Albany Financial of the Grower's rights and interest in the Project Management Contract, the Sub-lease, the Wood Purchase Agreement and all money payable to the Grower under them and the insurances. The assignment occurs upon default by the Grower or other events set out in clause 8.

43. The loan is provided by Albany Financial on a full recourse basis and recovery action will be taken in respect of any default by the borrower. Overdue repayments will incur interest at the default rate of 13% per annum.

44. This Ruling will not apply to Growers who enter into finance arrangements with Albany Financial or its associates, with terms and conditions that differ in any way from those set out in paragraphs 40 to 43.

45. 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;

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- 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 Albany Financial are involved or become involved in the provision of finance to Growers for the Project.

## Ruling

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### Application of this Ruling

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

- on or before 30 June 2003 and who have executed a Project Management Contract, Wood Purchase Agreement and a Sub-lease on or before that date (a '2003 Grower'); and/or
- on or after 1 July 2003 and on or before 26 March 2004 where the Grower has executed a Wood Purchase Agreement, Sub-lease and Project Management Contract on or between those dates (a '2004 Grower').

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

47. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted, the relevant agreements are executed as set out in paragraph 46 above and the Project has commenced.

48. This Ruling does not apply to Growers who are excluded from the Ruling by paragraphs 7, 8, 44 or 45 of this Product Ruling.

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

### *Division 328*

49. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. Changes to the STS rules apply from 1 July 2005. From that date, STS taxpayers may use the accruals accounting method or can continue to use the cash accounting method (called the 'STS accounting method' – see section 328-125).

### **Qualification**

50. 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*

51. 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.

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

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## Deductions for Application Amount, Management fees, Rent and Interest

### Section 8-1

53. A Grower who is not an 'STS taxpayer' and who is accepted into the Project on or before 30 June 2003 may claim, on a per hectare basis, tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Application Amount</b>	8-1	\$4,950 See Notes (i) & (ii) (below)		
<b>Management fees</b>	8-1		\$99 – (indexed) See Notes (i) & (iii) (below)	\$99 – (indexed) See Notes (i) & (iii) (below)
<b>Rent</b>	8-1		\$396 (indexed) - See Notes (i) & (iii) (below)	\$396 (indexed) See Notes (i) & (iii) (below)
<b>Interest on loan with Albany Financial Pty Ltd</b>	8-1	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)
<b>Insurance</b>	8-1	As incurred See Note (i) & (v) (below)	As incurred See Note (i) & (v) (below)	As incurred See Note (i) & (v) (below)
<b>Stamp duty on Sub-lease</b>	25-20	As incurred See Note (vi) (below)	Nil	Nil

### 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 at paragraph 118;
- (ii) The Application Amount is for 'seasonally dependent agronomic activities' and is deductible in the income year in which it is incurred;

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- (iii) Where a Grower who is not an 'STS taxpayer', pays the Management fee and the Rent in the relevant income years shown in the Project Management Contract and Sub-lease, those fees are deductible in full in the year that they are incurred. These fees are charged for providing maintenance services and for the lease of the land to a Grower until 30 June of the year in which the fees 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 (see paragraphs 82 to 88). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 88 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;
- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Albany Financial, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Albany Financial, should read the discussion of the prepayment rules in paragraphs 82 to 88 (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;
- (v) The insurance associated with the afforestation activities relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income is to be gained from this business. They will thus be deductible under the first limb of section 8-1; and
- (vi) The stamp duty incurred in relation to the Sub-lease is deductible under section 25-20. The expenditure is incurred in preparing, registering or stamping a lease over property used solely for the purpose of producing assessable income.

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54. A Grower who is not an 'STS taxpayer' and who is accepted into the Project on or after 1 July 2003 and on or before 26 March 2004 may claim, on a per hectare basis, tax deductions for the following revenue expenses:

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>	<b>Year ended 30 June 2006</b>
<b>Application Amount</b>	8-1	\$4,950 See Notes (i) & (ii) (above)		
<b>Management fees</b>	8-1		\$99 (indexed) See Notes (i) & (iii) (above)	\$99 (indexed) See Notes (i) & (iii) (above)
<b>Rent</b>	8-1	\$396 (indexed) See Notes (i) & (iii) (above)	\$396 (indexed) See Notes (i) & (iii) (above)	\$396 (indexed) See Notes (i) & (iii) (above)
<b>Interest on loan with Albany Financial Pty Ltd</b>	8-1	As incurred See Note (iv) (above)	As incurred See Note (iv) (above)	As incurred See Note (iv) (above)
<b>Insurance</b>	8-1	As incurred See Note (i) & (v) (above)	As incurred See Note (i) & (v) (above)	As incurred See Note (i) & (v) (above)
<b>Stamp duty on Sub-lease</b>	25-20	As incurred See Note (vi) (above)	Nil	Nil

## **Tax outcomes for Growers who are 'STS taxpayers'**

### **Assessable Income**

#### ***Section 6-5 and section 328-105***

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

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56. A Grower is assessable on ordinary income from carrying on their business of afforestation:

- in the year in which that income is received if the Grower is an 'STS taxpayer' continuing to use the cash accounting method; or
- in the year in which that income is derived if the Grower is an 'STS taxpayer' using the accruals accounting method.

## Deductions for Application Amount, Management Fees, Rent, and Interest

### *Section 8-1 and section 328-105*

57. A Grower who is an 'STS taxpayer' and who is accepted into the Project on or before 30 June 2003 may claim, on a per hectare basis, tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Application Amount</b>	8-1	\$4,950 See Notes (vii), (viii) & (ix) (below)		
<b>Management fees</b>	8-1		\$99 – (indexed) See Notes (vii), (viii) & (ix) (below)	\$99 – (indexed) See Notes (vii), (viii) & (ix) (below)
<b>Rent</b>	8-1		\$396 (indexed) See Notes (vii), (viii) & (ix) (below)	\$396 (indexed) See Notes (vii), (viii) & (ix) (below)
<b>Interest on loan with Albany Financial Pty Ltd</b>	8-1	When paid. See Notes (viii) & (x) (below)	When paid. See Notes (viii) & (x) (below)	When paid. See Notes (viii) & (x) (below)
<b>Insurance</b>	8-1	As incurred See Note (vii) & (xi) (below)	As incurred See Note (vii) & (xi) (below)	As incurred See Note (vii) & (xi) (below)
<b>Stamp duty on Sub-lease</b>	25-20	As incurred See Note (xii) (below)	Nil	Nil

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## Notes:

- (vii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits). See Example at paragraph 118;
- (viii) For all Growers who are 'STS taxpayers' (for the 2003-04 and 2004-05 income years) and for those Growers who are 'STS taxpayers' continuing to use the cash accounting method (for the 2005-06 income year):
- an amount, shown in the above table or in the table at paragraph 58, that is not paid in the year it is incurred is only deductible to the extent to which it has been paid; and
  - any amount or part of an amount shown in these tables which is not paid in the year in which it is incurred will be deductible in the year in which it is paid.

For Growers who are 'STS taxpayers' using the accruals accounting method, expenditure incurred in the 2005-06 income year is deductible in full in that year.

- (ix) The Application Amount is for 'seasonally dependent agronomic activities' and is deductible in the income year in which it is incurred;
- (x) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Albany Financial, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Albany Financial, should read the discussion of the prepayment rules in paragraphs 82 to 88 (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;
- (xi) The insurance associated with the afforestation activities relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income is to be gained from this business. They will thus be deductible under the first limb of section 8-1; and

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- (xii) The stamp duty incurred in relation to the Sub-lease is deductible under section 25-20. The expenditure is incurred in preparing, registering or stamping a lease over property used solely for the purpose of producing assessable income.

58. A Grower who is an 'STS taxpayer' and who is accepted into the Project on or after 1 July 2003 and on or before 26 March 2004 may claim on a per hectare basis, tax deductions for the following revenue expenses:

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>	<b>Year ended 30 June 2006</b>
<b>Application Amount</b>	8-1	\$4,950 See Notes (vii), (viii) & (ix) (above)		
<b>Management fees</b>	8-1		\$99 – (indexed) See Notes (vii), (viii) & (ix) (above)	\$99 – (indexed) See Notes (vii), (viii) & (ix) (above)
<b>Rent</b>	8-1	\$396 (indexed) See Notes (vii), (viii) & (ix) (above)	\$396 (indexed) See Notes (vii), (viii) & (ix) (above)	\$396 (indexed) See Notes (vii), (viii) & (ix) (above)
<b>Interest on loan with Albany Financial Pty Ltd</b>	8-1	When paid. See Notes (viii) & (x) (above)	When paid. See Notes (viii) & (x) (above)	When paid. See Notes (viii) & (x) (above)
<b>Insurance</b>	8-1	As incurred See Note (vii) & (xi) (above)	As incurred See Note (vii) & (xi) (above)	As incurred See Note (vii) & (xi) (above)
<b>Stamp duty on Sub-lease</b>	25-20	As incurred See Note (xii) (above)	Nil	Nil

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

### **Deferral of losses from non-commercial business activities**

#### ***Division 35***

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

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

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 107 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)).

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

62. Growers are reminded of the important statement made on page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in subsection 35-55(1) 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.

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## Section 82KL, and Part IVA

63. For a Grower who participates in the Project and incurs expenditure as required by the Project Management Contract and the Sub-lease the following provisions of the ITAA 1936 have application as indicated:

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

## Explanations

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### Is the Grower carrying on a business?

64. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the W.A. Blue Gum Project 2003 must amount to the carrying on of a business of primary production.

65. Where there is a business, or a future business, the gross proceeds from the sale of 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.

66. For schemes such as that of the W.A. Blue Gum 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.

67. 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;

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- 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.

68. In this Project, each Grower enters into a Project Management Contract, Wood Purchase Agreement and a Sub-lease.

69. Under the Sub-lease each individual Grower will have rights over a specific and identifiable area of at least 6 hectares of land. The Sub-lease provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Sub-lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Sub-lease allows the Grower and the Grower's contractors to come on to the land.

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

71. The Wood Purchaser is engaged to harvest and purchase the wood produce grown on the Grower's land under the Wood Purchase Agreement.

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

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

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

75. The Project 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 plantation is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

77. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the W.A. Blue Gum Project 2003 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

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

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

## **Deductibility of Application, Management fees and Rent**

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

80. Consideration of whether the initial Application Amount is 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,

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and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

81. The fees payable under the Project Management Contract and Sub-lease are associated with the afforestation activities. The fees will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of wood produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purposes in incurring the fees are identifiable from the arrangement. The fees appear to be reasonable. The Application Amount has no capital component. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

## **Prepayment provisions**

### *Sections 82KZL to 82KZMG*

82. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g. the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

83. For this Project, only section 82KZL (an 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*

84. Other than expenditure deductible under section 82KZMG, if the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the

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ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

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

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

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

87. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

88. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section

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82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

89. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

## Section 82KZMG

90. Under 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).

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

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

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

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

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manages, arranges or promotes similar agreements.

93. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling.

94. Subsection 82KZMG(5) defines the 'establishment period' to commence at the time that the first 'seasonally dependent agronomic activity' is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

## **Application of the prepayment provisions to this Project**

95. Under the Project Management Contract, a Grower incurs an Application Amount in Year 1 consisting of expenditure of \$4,950 per hectare for 'seasonally dependent agronomic activities'.

96. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year in which the expenditure is incurred under the Project Management Contract for 'seasonally dependent agronomic activities'.

## **Interest deductibility**

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

#### *(i) Growers who use Albany Financial as the finance provider*

97. Some Growers may finance their participation in the Project through a loan facility with Albany Financial. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of fees incurred under the Project Management Contract and the Sub-lease.

98. The interest incurred for the year ended 30 June 2003 or 30 June 2004, for 2003 and 2004 Growers respectively, and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing trees and the Sub-lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

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99. In the absence of any application of the prepayment provisions (see paragraphs 83 to 89), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

100. Interest is deductible in the year in which it is incurred by Growers who are not 'STS taxpayers' or by Growers who are 'STS taxpayers' using the accruals accounting method for the 2005-06 income year.

101. For all Growers who are 'STS taxpayers' for the 2003-04 and 2004-05 income years and for Growers who are 'STS taxpayers' continuing to use the cash accounting method for the 2005-06 income year, interest is not deductible until it has been both incurred and paid. If interest that is incurred in an income year remains unpaid at the end of the income year, the unpaid amount is deductible in the income year in which it is paid.

*(ii) Growers who DO NOT use Albany Financial as the finance provider*

102. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Albany Financial 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.

103. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 83 to 89).

## **Deferral of losses from non-commercial business activities**

### ***Division 35***

104. 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;

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- 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.

105. 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.

106. 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.

107. 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.

108. 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).

109. 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 the activity of a Grower who acquires the minimum allocation of six hectares in the Project will produce a taxable profit in the year ended 30 June 2013. In the loss years up until that year, these Growers will not pass one of the tests. Growers who acquire more than six interests

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in the Project may however, find that their activity meets one of the tests.

110. 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.

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

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

112. This Product Ruling is issued on a prospective basis (i.e. before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 59), in the manner described in the Arrangement (see paragraphs 14 to 45). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

- the report of the independent forester provided with the application by WABG; 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 WABG.

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## **Losses and Outgoings incurred under Certain Tax Avoidance Schemes**

### *Section 82KL - recouped expenditure*

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

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

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

116. The W.A. Blue Gum Project 2003 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 53, 54, 57 and 58 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

## **Example**

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

118. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 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

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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

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**Commissioner of Taxation**

4 June 2003

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*Previous draft:*

Not previously issued in draft form

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