



PR 2003/79 - Income tax: The Woods & Forests Management Trust Prospectus No.7 - April 1996

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Product Ruling

Income tax: The Woods & Forests Management Trust Prospectus No.7 - April 1996

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Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee 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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Woods & Forests Management Trust', or simply as 'the Project'.

Tax law(s)

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

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons who were accepted into the project between 15 April 1996 and 14 April 1997. At the time of entering the project they had (and continue to have) a purpose of staying in the arrangement until it is completed (i.e. being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project. Also, this Ruling does not apply to Growers who elect to collect and sell their own timber. Growers who do not exercise this election are referred to as 'non-electing Growers'.

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 17 December 2003 for Growers who, between 15 April 1996 and 14 April 1997, entered into the specified arrangement that is set out below. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. Even following its withdrawal, this Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement that is set out below between 15 April 1996 and 14 April 1997. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 9 April 2002 as constituted by documents provided on 28 October 2002 and 25 March 2003 and additional correspondence dated 6 June 2003, 18 August 2003, 15 September 2003, 7 November 2003 and 18 November 2003;
- Woods & Forests Management Trust Prospectus dated 15 April 1996 prepared and issued by Woods & Forests Management Limited;
- **Woods & Forests Management Trust Deed** between Woods & Forests Management Limited, IOOF Australia Trustees Limited, Glynde Management Pty Ltd and the Grower dated 26 May 1992;

- Sample **Lease Agreement** between Glynde Management Pty Ltd and the Grower;
- Sample **Management and Works Agreement** between Woods & Forests Management Limited and the Grower; and
- Annual Reports of the Consultant Forester for the periods: August 2001 to September 2002, August 2000 to September 2001, the 1999 financial year, the 1997 financial year, the 1996 financial year and the 1995 financial year.

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

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

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

Overview

17. The features of the Woods & Forests Management Trust Project are as follows:

Location	North East Tasmania
Type of business each participant is carrying on	Commercial growing of <i>Eucalyptus Nitens</i> (Shining Gum) for the production of hardwood woodchips.
Size of each lot	½ hectare
Average number of trees planted per hectare	1100 – 1200
Term of the Project	Approximately 15 years
Minimum subscription per Grower	1 lot
Initial cost per lot	\$3,600
Initial cost per hectare	\$7,200
Ongoing costs	Growers are required to pay 10% of gross sale proceeds as a Marketing Fee Rent of \$75 per annum indexed to the

	Consumer Price Index
	Insurance cover after the first year if required by the Grower

18. The Woods & Forests Management Trust Project carries on a long term silvicultural Project to cultivate and harvest *Eucalyptus Nitens* (Shining Gums) for premium hardwood chips. The Project land is situated in the north east of Tasmania. The Project term is for a period of 15 years. The Manager of the Project is Woods & Forests Management Limited. The Trustee is Tower Trust (SA) Limited (formerly named IOOF Australia Trustees Limited). The Owner of the Project land is Glynde Management Pty Ltd.

19. Growers participating in the Project entered into Lease and Management and Works Agreements.

20. Under the Lease Agreement, the Grower obtained an interest in the land in the form of a lease. Each leased area, referred to as a 'lot', is 0.5 hectares in size. The lease period is for 15 years or until clear felling, whichever occurs first.

21. Each lot is identified on a plan of the plantation which is attached to the Lease Agreement. The Project was fully subscribed. The minimum holding is 1 lot per Grower. Growers executed a Power of Attorney which enabled the Manager to act on their behalf.

22. The Grower engaged the Manager to plant between one thousand and one thousand three hundred trees per hectare in the first planting season after the Project had commenced. In addition, the Manager has been engaged by each Grower to maintain the leased area, harvest and sell the timber produce, on their behalf.

23. The Manager's estimate of the projected cash distribution from the Project is contained in the Prospectus. The Prospectus also identifies the risks associated with the Project. The Project will terminate on the date upon which all trees have been clear felled.

Trust Deed

24. The Trust Deed established the Project and constitutes the Agreement between the Growers, the Manager, the Owner of the Project land and the Trustee. The Trust Deed stipulates the terms, conditions, rights and responsibilities under which the Manager has agreed to act for the Growers and manage the Project. In addition, the Trust Deed specifies the terms under which the Trustee is appointed to represent the Growers and ensure that the Manager and Owner of the Project land comply with their obligations under the Trust Deed.

25. The Manager maintains a register of Growers. Subject to certain conditions in the Trust Deed, Growers may assign their interest in the Project. The Lease and Management and Works Agreements are annexed to the Trust Deed. These Agreements were executed once the Grower signed the Application and Power of Attorney Form.

Interest in Land

26. Under the Lease Agreement, Growers entered into a Lease Agreement with the Owner of the Project land. Each Grower pays rent to the Owner of \$75 per lot (indexed to the Consumer Price Index after the first year). From 1 July 2000, this fee includes GST. This Agreement entitles the Grower to use the property for the purposes of establishing, maintaining and subsequently harvesting trees for use in the woodchip industry. Subject to the conditions contained in clauses 4 and 5 of this Agreement, the Grower is entitled to a right of way over the common areas and at all times has full right, title and interest in the timber produce from the leased area. At the expiration of the lease, the Grower will deliver up the Plantation to the Owner in such state, order and condition as described in the Agreement.

Management and Works Agreement

27. Under the Management and Works Agreement, the Grower appointed the Manager to manage the Grower's interest in the Project.

28. In consideration for the Establishment and Maintenance Fee, the Manager was required to carry out the following services within the first 13 months of the Agreement:

- prepare, improve and maintain the plantation including:
 - laying out and maintaining fire breaks and access roads;
 - taking such steps as possible to keep the plantation free from vermin, insect infestation and competing vegetation;
 - applying fertilisers and herbicides to maintain optimum growth;
- provide and plant *Eucalyptus Nitens* seedlings to a density of between 1000 and 1300 seedlings per hectare and replace and replant seedlings which die within the first 12 months of planting. After the first 12 months of planting, the Manager will not be obliged to replace seedlings if more than 90% of the planted seedlings have survived. The cost of replacing the seedlings is

borne by the Grower if the cause of death is beyond the reasonable control of the Manager; and

- maintain the seedlings until they are planted in accordance with sound silvicultural practice.

29. In consideration for the Marketing Fee, the Manager carries out the following services for the term of the Agreement:

- regular inspection of trees and attend to the maintenance of vehicular access tracks;
- maintain boundary fences; and
- take such steps in accordance with normal practices to cultivate, tend and care for the trees and to maintain fire breaks and fire prevention facilities and access roads.

30. The Owner of the Project land has agreed to fund the Manager's obligations under the Management and Works Agreement for the term of the Project.

Fees

31. The following fees are paid by the Grower on a per lot basis:

- rent of \$75 per annum (indexed to the Consumer Price Index after the first year) is paid to the Owner of the Project land. The rent is payable on application and on 30 June of each year thereafter. From 1 July 2000, this fee includes GST;
- an Establishment and Maintenance Fee of \$3,525 was paid to the Manager on application, for the first 13 months of operation; and
- at harvest or thinning, the Grower pays a Marketing Fee equivalent to 10% of the gross sale proceeds to the Manager.

32. The Trust Deed provides for the Grower to reimburse the Manager for expenses which are not common in meeting the usual level of silvicultural conditions. In addition, the Manager will use its best endeavours to arrange insurance on behalf of the Grower. After the first year, the Grower must reimburse the Manager for the cost of the insurance. The Grower is also liable to pay the Trustee and Manager for certain other costs, under clause 10 of the Trust Deed.

33. The Consultant Forester considers that the Project should meet its objectives based on the intensive management regime planned by the Manager. In addition, the Annual Reports of the Consultant Forester state that the standard of the works is in accordance with good silvicultural practice.

34. Application monies received by the Manager were paid to the Trustee and were held by the Trustee in authorized Trustee investments. The application monies were applied as specified in clause 2.5 of the Trust Deed.

Harvesting

35. Harvesting may take place from years 8 to 10 for thinnings and from years 12 to 15 for clear fell. The Manager will determine when the trees are to be thinned or clear felled, advise the Trustee to retain a Consultant Forester to determine an estimate of the current price per cubic metre of the logs and will notify the Growers of the current market price. Growers may elect to sell their own timber if they notify the Manager within 28 days of receiving notification of the current market price that they are able to secure a higher price. The Manager will arrange for the marketing and sale of the trees for those Growers who do not elect to sell their own timber.

36. The proceeds from the sale of the timber will be paid into an account which is established by the Trustee. The proceeds will be distributed to the Grower in proportion to their respective interest, after payment to the Manager of the Marketing Fee and reimbursement of certain costs and expenses incurred by the Trustee and Manager, as defined in clauses 10.4 and 10.5 of the Trust Deed.

Finance

37. Growers funded their investment in the Project themselves or borrowed from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the *Income Tax Assessment Act 1936* 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

Application of this Ruling

39. This Product Ruling applies to Growers who are within the specified class of persons to whom this Ruling applies (see paragraphs 7 and 8). Growers who elect to market and sell their own timber are excluded from the class of persons to whom this Ruling applies.

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

Section 35-55 – Commissioner’s discretion

40. For a Grower who is an individual and who entered the Project between 15 April 1996 and 14 April 1997 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 2001 to 30 June 2011 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 the Arrangement section of this Product Ruling.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 47 in the Explanation part of this Ruling); 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)).

42. Where, the ‘exception’ in subsection 35-10(4) applies, the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

43. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in 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.

Explanation

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

44. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

45. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer’s allowable deductions attributable to the business activity over that taxpayer’s assessable income from the business activity.

46. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

47. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business 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.

48. In broad terms, the tests require:

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

49. A Grower who 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 acquired the minimum allocation of one lot in the Project is unlikely to have their activity pass one of the tests.

50. 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 a Grower's participation in the Project.

51. 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.

52. Information provided with this Product Ruling indicates that a Grower who acquired the minimum investment of one lot in the Project is expected to be carrying on a business activity that will produce a taxation profit in the income year ended 30 June 2012.

53. 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 2011. Any profit that may arise under a thinnings harvest prior to clear fell harvest will not affect the Commissioner's discretion as it is considered to be a one off event that is specific to the afforestation industry.

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

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

- the report of the independent forester and additional evidence provided with the application by the 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.

Detailed contents list

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

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of a business
- management fees
- primary production
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- non commercial losses

Legislative references:

- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1936 Pt IVA
- ITAA 1936 82KL
- TAA 1953 Part IVAAA
- Copyright Act 1968

ATO references:

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