



PR 2004/19 - Income tax: Queensland Paulownia Forests Project No. 8

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 This document has changed over time. This is a consolidated version of the ruling which was published on *25 January 2006*



Product Ruling

Income tax: Queensland Paulownia Forests Project No. 8

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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.*

[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

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.

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 investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Queensland Paulownia Forests Project No. 8' or simply as 'the Project'.

Tax law(s)

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

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

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

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it. Growers who elect to market their own timber 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

11. This Ruling applies prospectively from 25 February 2004, 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).

Note: The Addendum to this Ruling that issued on 25 January 2006 applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling from Queensland Paulownia Forests Ltd (QPFL) dated 6 November 2003 for a Product Ruling constituted by documents provided on 11 November 2003, 2, 16 and 19 December 2003 and 13 and 16 February 2004 and additional correspondence dated 6, 9, 13 and 16 February 2004 in respect of Queensland Paulownia Forests Project No. 8;
- Draft Product Disclosure Statement issued by QPFL and dated 3 November 2003;
- Constitution of QPFL Project No. 8 dated 19 December 2003, ('the Constitution');
- Draft Lease between Quality Land Holdings Pty Ltd ('Lessor') and QPFL ('Lessee'), undated, received on 2 December 2003;
- **Farming Agreement between QPFL and the Grower** dated 6 November 2003;
- **Plantation and Maintenance Agreement between QPFL and the Grower** ('the Plantation and Maintenance Agreement') dated 13 February 2004; and
- United Pacific Finance Pty Ltd **Loan Agreement** for Growers received by the ATO on 16 December 2003.

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

15. The documents highlighted are those that Growers 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 as follows.

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 Queensland Paulownia Forests Project No. 8 are as follows:

Location	Forbes, NSW
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Paulownia fortunei</i> trees for the purpose of harvesting and selling timber
Number of Woodlots on offer	3,000
Minimum number of Woodlots per application	1
Number of hectares available	500 hectares
Size of each Woodlot	0.1667 hectares
Number of trees per Woodlot	50
Incentive fee	Responsible Entity will be entitled to ½ of the amount paid to the Grower over and above the 'Gross Sale Proceeds from Timber' set out in the Product Disclosure Statement.
The term of the investment	The date Harvest and Milling of all Trees has been completed.
Initial cost	\$5,500 per Woodlot
Initial cost per hectare	\$32,993
Ongoing costs	Maintenance fees, licence fees, harvesting and milling, and marketing fees. Insurance (where applicable).

18. Under the Product Disclosure Statement, applicants are invited to participate in the Queensland Paulownia Forests Project No. 8. Growers entering into the Project will enter into the Farming Agreement that gives them a licence over an area of land called a 'Woodlot'. The Land Owner (Quality Land Holdings Pty Ltd) leases the land, at Forbes, NSW, to Queensland Paulownia Forests Limited (QPFL), the Responsible Entity, who grants a licence to the Growers. The licence allows the Project Manager, QPFL, to come onto the land to carry out its obligations under the Plantation and Maintenance Agreement. QPFL conducts its role as Responsible Entity and advisor under its Australian Financial Services Licence number 222305. QPFL provides agricultural services to the Project under its role as Project Manager. The Growers will also enter into the Plantation and Maintenance Agreement with QPFL to have paulownia trees

(*Paulownia fortunei*) planted on the Woodlot for the purpose of eventual felling and sale commencing when the Responsible Entity, in conjunction with the Project Forester, determines the Trees are suitable for Harvesting (clause 5.1(a)).

19. There are 3,000 Woodlots on offer of 0.1667 hectares each at a cost of \$5,500 per Woodlot. The total land area for the Project will be 500 hectares. A minimum of 50 trees per Woodlot (300 per hectare) will be planted within the first 12 months following execution of the Plantation and Maintenance Agreement.

Farming Agreement

20. Under the Farming Agreement, Growers are granted a licence by QPFL to use their Woodlot for the purpose of conducting their afforestation business (clause 2.1). The Growers must pay QPFL an initial licence fee of \$110 per Woodlot for the first twelve months (clause 6).

21. The term of the Agreement is either until harvesting and milling of all trees has been completed, whichever is the latest (clause 3.1). The Grower must pay 2.42% of the 'Gross Sale Proceeds of Timber' for re-imbusement of ongoing licence fees.

Plantation and Maintenance Agreement

22. The Plantation and Maintenance Agreement for each Woodlot is entered into by the Grower and QPFL. The term of the Agreement will continue until the Harvest and Milling of all Trees has been completed (cl 3(a)).

23. The services to be provided by QPFL for an annual fee over the term of the Project are outlined in clause 4. In re-imbusement of the annual fee, the Grower pays 3.63% of the 'Gross Sale Proceeds from Timber' at the time of harvest. QPFL will be responsible for planting *Paulownia fortunei* on the Woodlot and will then maintain the trees in accordance with good silvicultural practice until maturity.

24. The services to be provided by QPFL in clause 4.1 include duties to:

- a) acquire Trees for the Grower in the form of clonal tissue and seedlings for propagation, which Trees will be the property of the Grower for the duration of this Agreement;
- b) prepare the Land with adequate drainage for the Trees;

- c) establish, tend and maintain the Trees and Woodlot in a proper and skilful manner and as and when appropriate prepare, cultivate, spray herbicides and insecticides, and plant and fertilise Tree seedlings;
- d) comply with the laws and regulations relating to the use and occupancy of the Woodlot;
- e) embark on such operations as may be required to prevent or combat land degradation which may affect the yield of the Trees;
- f) keep accurate records of payments;
- g) carry out any obligations imposed on the Grower under the provisions of the Farming Agreement (except for the payment of fees by the Grower); and
- h) carry out any obligations of the Responsible Entity under the Constitution and Compliance Plan.

25. The Responsible Entity, QPFL, must perform the services under clause 4 as soon as practicable (clause 4.2), and must perform the services in clause 4.3 from the commencement of the 13th month of this Agreement onward and on an annual basis until this Agreement is at an end (clause 4.3). Initially seedlings propagated at Palm Range, Queensland may be used and a 'pole' nursery will be established at Forbes to provide stock for any replanting required. The seedlings will be 'acclimatised' or 'hardened off' prior to dispatch and before planting.

26. Prior to 30 June 2012, Growers may elect to collect the timber attributable to their Woodlots (Electing Growers) (clause 9.1), with at least three months written notice to the Responsible Entity, instead of having it milled and marketed on their behalf by QPFL. **This Ruling will not apply to Electing Growers.** If no such election is made, QPFL will sell the timber attributable to the Woodlots on the (Non-Electing) Grower's behalf, for the best possible commercial price (clause 6.2). QPFL will then be entitled to a marketing fee of 4.95% of the gross proceeds from the sale of the timber. Harvesting and milling of trees will take place when the Responsible Entity, in conjunction with the Project Forester, determines the Trees are suitable for Harvesting (clause 5(a)).

27. Growers who do not elect to collect their own timber will have the gross proceeds of sale of the timber attributable to their Woodlots paid to the Responsible Entity in its capacity as Custodian of the Project. The Responsible Entity will retain from the payment the Grower's proportional interest of the harvesting and milling costs, other costs of sale, licence and maintenance fees owing by the Grower and the Marketing and Incentive fee (clause 5 and clause 10.1). After payment of these expenses, the Responsible Entity will account to the

Grower and pay the Grower his/her share of the net proceeds of sale. Each grower's proportionate share of the sale proceeds of the pooled wood products will reflect the proportion of the trees contributed from their woodlot (clause 7).

Constitution

28. The Constitution is between QPFL (in its capacity as the Responsible Entity) and Growers. The Constitution sets out the terms and conditions under which QPFL agrees to act for the Growers and under which QPFL agrees to manage the Project. QPFL keeps a Grower register. Growers are only entitled to assign the Grower's Interest in certain circumstances (clause 18). Growers are bound by the Constitution by virtue of their participation in the Project.

Fees

29. The fees payable under clause 10 of the Plantation and Maintenance Agreement are:

- i) \$5,390 per Woodlot for the Establishment services provided after the acceptance of the Application for a Woodlot made under the Product Disclosure Statement. The services to be provided are those in paragraph 24 above as listed in 4.1(a) to (h) of the Plantation and Maintenance Agreement. Of this \$5,390 figure, 100% is for 'seasonally dependent agronomic activities';
- ii) 3.63% of the 'Gross Sale Proceeds from Timber' for re-imbusement of ongoing maintenance fees is payable at the time of harvest or \$92.40 per year for each year the Project has been in operation in the absence of any harvest due to the destruction of the Grower's Woodlot;
- iii) An incentive fee calculated to be half of the amount paid to the Grower over and above the 'Gross Sale Proceeds from Timber' set out in the Product Disclosure Statement for the Project;
- iv) A marketing fee of not more than 4.95% of the gross proceeds generated from the sale of timber attributable to the Grower's Woodlot where QPFL sells on the Growers behalf; and
- v) All harvesting and milling costs.

30. The fee payable under clause 6 of the Farming Agreement is an initial licence fee of \$110 per Woodlot paid on application under the Product Disclosure Statement. 2.42% of the 'Gross Sale Proceeds from Timber' is payable at the time of harvest for re-imburement of ongoing licence fees or \$61.60 per year for each year the Project has been in operation in the absence of any harvest due to the destruction of the Grower's Woodlot.

31. The Responsible Entity will hold the application moneys in an application account to be released when certain specified criteria in the Constitution have been met (clause 15).

Finance

32. There will be no financing facility offered by the Responsible Entity or any other related third party to the arrangement. Growers can fund their investment in the Project themselves, by borrowing from United Pacific Finance Pty Limited ('UPF') (a lender not associated with the Responsible Entity) or by borrowing from another independent lender.

33. Finance will be provided to Growers by UPF under the following finance arrangements:

- i) Facility 1 – Payment of 10% deposit followed by monthly repayments of principle and interest over 5 years;
- ii) Facility 2 – Payment of 10% deposit followed by monthly payments of interest only for first 2 years, then monthly repayments of principle and interest for 5 years; or
- iii) Facility 3 – Payment of 10% deposit followed by monthly payments of interest only for first 3 years, then monthly repayments of principle and interest for 7 years.

All loans are subject to 11.45 % per annum interest rates based on current interest rates. All payments will be monthly by direct debit on UPF's Direct Debit System. Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears. The establishment fees will be \$250.00 plus 1% of each respective loan, with a cap of \$1,250.00 per loan application. The maximum advance will be \$250,000 per borrower, subject to meeting of the agreed credit criteria.

34. This Ruling will not apply to Growers if the Responsible Entity accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application, is not paid to the Responsible Entity by 30 June in the year of Application. The Application Price must be paid before or contemporaneously with the acceptance of the Application in accordance with the terms of clause 13 of the Constitution and such funds are to be paid into the Application Fund Account in accordance with the terms of clause 12 of the Constitution.

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

- There are split loan features of a type referred to in Taxation Ruling TR 98/22;
- There are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'Additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- The loan or rate of interest is non-arm's length;
- Repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- The funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or
- Lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- 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

36. This Ruling applies only to Non-Electing Growers who are accepted to participate in the Project on or before 30 June 2005 and who have executed a Plantation and Maintenance Agreement and a Farming Agreement on or before that date. The Grower's participation

in the Project must constitute the carrying on of a business of primary production.

37. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

38. 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. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where the Grower uses the cash accounting method.

Qualification

39. 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.

Prepaid initial licence fees

Sections 82KZME and 82KZMF

40. The initial licence fees incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii) below).

41. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

In this Project, the tax deductions allowable for the initial licence fees must be calculated by applying the above formula to the amount incurred by the Grower.

Assessable Income

Section 6-5 and section 328-105

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

43. A Grower will recognise ordinary income from carrying on the business of afforestation at the time that income is derived when they are:

- not an 'STS taxpayer'; or
- an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years.

44. A Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is received.

Deductions for Establishment services fees, licence fees and interest

Section 8-1 and section 328-105

45. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table below.

46. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the

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Grower. Any amount or part of an amount shown in the Table below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid. The years shown in the Table below relate to a Grower who is accepted into the Project on or before 30 June 2004. Deductions are available one year later for Growers accepted into the Project after 30 June 2004 and on or before 30 June 2005.

Fee Type	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Establishment services fee	\$5390.00 See Notes (i) & (ii)		
Licence fee	See Notes (i) & (iii)		
Interest incurred or paid to UPF	As incurred (Non-STs taxpayers) Or as paid (STs taxpayers) See Note (iv)	As incurred (Non-STs taxpayers) Or as paid (STs taxpayers) See Note (iv)	As incurred (Non-STs taxpayers and STs taxpayers using accruals accounting) Or as paid (STs taxpayers) See Note (iv)

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 120.
- (ii) The Establishment service fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 79 to 83) and is deductible in the income year in which it is incurred (where the Grower **is not** an 'STs taxpayer' using the cash accounting method) or the year in which it is paid (where the Grower **is** an 'STs taxpayer' using the cash accounting method).
- (iii) Although the Farming Agreement requires the licence fee to be prepaid, for a Grower who acquires the minimum allocation, the amount of the prepaid licence fee is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 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 (where the Grower **is not** an 'STS taxpayer' using the cash accounting method) or the year in which it is paid (where the Grower **is** an 'STS taxpayer' using the cash accounting method). However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid licence fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for the prepaid licence fee using the formula shown above in paragraph 41.

- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than UPF, is outside the scope of this Ruling. Growers who borrow from lenders other than UPF may request a Private Binding Ruling on the deductibility of the interest incurred. However all Growers, including those who finance their participation in the Project other than with UPF should read the discussion of the prepayment rules in paragraphs 71 to 78 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

47. For a Grower who is an individual and who enters the Project during the year ended 30 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2004 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 this Ruling.

48. For a Grower who is an individual and who enters the Project during the year ended 30 June 2005 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 2005 to 30 June 2012 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

49. 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 103 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)).

50. 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.

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

Section 82KL and Part IVA

52. For a Grower who participates in the Project and incurs expenditure as required by the Plantation and Maintenance Agreement and the Farming Agreement the following provisions of the ITAA 1936 have application as indicated:

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

Explanation

Is the Grower carrying on a business?

53. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s afforestation activities as a

participant in the Queensland Paulownia Forests Project No. 8 must amount to the carrying on of a business of primary production.

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

55. For schemes such as that of the Queensland Paulownia Forests Project No. 8, 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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Grower has an identifiable interest by licence in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

57. In this Project, each Grower enters into a Plantation and Maintenance Agreement and a Farming Agreement.

58. Under the Farming Agreement each individual Grower will have rights over a specific and identifiable area of 0.1667 hectares of land. The Farming Agreement provides the Grower with an ongoing interest in the specific trees on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The licence allows the Project Manager to come onto to the land to carry out its obligations under the Plantation and Maintenance Agreement.

59. Under the Plantation and Maintenance Agreement the Project Manager is engaged by the Grower to establish and maintain a Woodlot 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 Establishment services to establish and maintain the Woodlot on the Grower's behalf.

60. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the timber grown on the Grower's Woodlot.

61. 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.

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

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

64. 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 Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable.

65. The Grower's degree of control over the Project Manager as evidenced by the Plantation and Maintenance Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Woodlot 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.

66. 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 Queensland Paulownia Forests Project No. 8 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

67. 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.

68. 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 Establishment services fees and licence fees

Section 8-1

69. Consideration of whether the Establishment services fees and licence fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

70. The Establishment services fees and licence fees associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of timber) 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 fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Establishment services fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions***Sections 82KZL to 82KZMG***

71. 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 licensing 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.

72. 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

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

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

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and

- either :
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

75. 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 UPF. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the resulting interest deductions 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.

76. 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.

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

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

78. 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

79. Under section 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the

prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

80. Subsection 82KZMG(2) requires that the expenditure is
- incurred on or after 2 October 2001 and on or before 30 June 2006;
 - the eligible service period must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year; and
 - for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

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

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

82. 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.

83. 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

84. Under the Plantation and Maintenance Agreement, a Grower incurs a Establishment services fee consisting of expenditure of \$5,390.00 for 'seasonally dependent agronomic activities'.
85. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2004, for Growers accepted into the Project on or before 30 June 2004, or in the income year ended 30 June 2005, for Growers accepted into the Project after 30 June 2004 and on or before 30 June 2005, for the expenditure incurred under the Plantation and Maintenance Agreement for 'seasonally dependent agronomic activities'.
86. The Plantation and Maintenance Agreement also requires that a Grower incurs a Maintenance Fee of 3.63 % of the Gross Sales Proceeds of the timber or \$92.40 per year in the absence of any harvest for the performance of maintenance services during the term of the Project.
87. The Maintenance Fee incurred under the Plantation and Maintenance Agreement for Years 2 to 11 is not prepaid. This fee is charged for providing maintenance in each of the years from years 2 to 11 during which the fees are incurred.
88. On this basis, the basic precondition in subsection 82KZME (2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the maintenance fees in Years 2 to 11.
89. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.
90. Under the Farming Agreement, a Grower is required to pay an initial licence fee of \$110.00 for the first 12 month period. The Farming Agreement also requires that a Grower incurs a licence fee of 2.42% of Gross Sales Proceeds or \$61.10 per year for each year of the term of the Project in the absence of any harvest.
91. The expenditure incurred by a Grower in the Project for the initial licence fee meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

92. The prepaid initial licence fee, being an amount of less than \$1,000 in the expenditure year, constitutes an 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the initial licence fee in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the initial licence fee in the income year in which it is incurred.

93. However, where a Grower acquires more than the minimum allocation of one interests in the Project and the quantum of the prepaid initial licence fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

Interest deductibility

Section 8-1

(i) Growers who use UPF as the finance provider

94. Some Growers may finance their participation in the Project through a loan facility with UPF. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of licence and Establishment services fees.

95. The interest incurred for the year ended 30 June 2004 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 licence 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.

96. As with the management fees, in the absence of any application of the prepayment provisions (see paragraphs 71 to 78), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

97. If the Grower is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

98. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Grower. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid, or is paid for the Grower.

(ii) Growers who DO NOT use UPF as the finance provider

99. 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 UPF 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.

Deferral of losses from non-commercial business activities

Division 35

100. 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 satisfied; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

101. 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.

102. 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 satisfied, the discretion is exercised, or the exception applies.

103. 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.

104. 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).

105. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one Woodlot during the year ended 30 June 2004 in the Project is unlikely to have their activity satisfy one of the tests until the income year ended 30 June 2014. Similarly, for a Grower who acquires the minimum allocation of one Woodlot during the year ended 30 June 2005 in the Project is unlikely to have their activity satisfy one of the tests until the income year ended 30 June 2015. Growers who acquire more than one interest in the Project may however, find that their activity satisfies one of the tests in an earlier income year.

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

107. 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 satisfy one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

108. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Woodlot during the year ended 30 June 2004 in the Project is expected to be carrying on a business activity that will satisfy one of the tests in the income year ended 30 June 2014, or will produce a taxation profit, for the income years ended 30 June 2012, 30 June 2013 and 30 June 2014.

109. 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.

110. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Woodlot during the year ended 30 June 2005 in the Project is expected to be carrying on a business activity that will satisfy one of the tests in the income year ended 30 June 2015, or will produce a taxation profit, for the income years ended 30 June 2013, 30 June 2014 and 30 June 2015.

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

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 paragraphs 47 and 48), in the manner described in the Arrangement (see paragraphs 14 to 35). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1), 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) 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 and additional expert or scientific evidence provided with the application by the Responsible Entity; and

- independent, objective, and generally available information relating to the Paulownia industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by QPFL.

Section 82KL - recouped expenditure

114. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the ‘additional benefit’ plus the ‘expected tax saving’ in relation to that expenditure equals or exceeds the ‘eligible relevant expenditure’.

115. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The ‘expected tax saving’ is essentially the tax saved if a deduction is allowed for the relevant expenditure.

116. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient ‘additional benefits’ will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

117. 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).

118. The Queensland Paulownia Forests Project No. 8 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 paragraph 46 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.

119. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvest and sale of the timber. 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

Entitlement to GST input tax credits

120. 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 2003, Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (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 2004, 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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Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

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

Other Related Rulings/Determinations:

TR 2001/14; TD 2003/12

Subject references:

- advance deductions and expenses for
 certain forestry expenditure
 - carrying on a business
 - commencement of business
 - fee expenses
 - forestry agreement
 - interest expenses
 - management fees
 - non commercial losses
 - producing assessable income
 - product rulings
 - public rulings
 - seasonally dependent agronomic
 activity
 - taxation administration
 - tax avoidance
 - tax benefits under tax avoidance
 schemes
 - tax shelters
 - tax shelters project

Legislative references:

- ITAA 1936 Pt III Div 3 Subdiv H
 - ITAA 1936 82KH(1)
 - ITAA 1936 82KH(1F)(b)
 - ITAA 1936 82KL
 - ITAA 1936 82KL(1)
 - ITAA 1936 82KZL
 - ITAA 1936 82KZL(1)
 - ITAA 1936 82KZME
 - ITAA 1936 82KZME(1)
 - ITAA 1936 82KZME(2)
 - ITAA 1936 82KZME(3)

- ITAA 1936 82KZME(4)
 - ITAA 1936 82KZME(7)
 - ITAA 1936 82KZMF
 - ITAA 1936 82KZMF(1)
 - ITAA 1936 82KZMG
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 - ITAA 1936 82KZMG(2)
 - ITAA 1936 82KZMG(3)
 - ITAA 1936 82KZMG(4)
 - ITAA 1936 82KZMG(5)
 - ITAA 1936 Pt IVA
 - ITAA 1936 177A
 - ITAA 1936 177C
 - ITAA 1936 177D
 - ITAA 1936 177D(b)
 - ITAA 1997 6-5
 - ITAA 1997 8-1
 - ITAA 1997 17-5
 - ITAA 1997 Div 27
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 - ITAA 1997 35-10
 - ITAA 1997 35-10(2)
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 - ITAA 1997 35-10(4)
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 - ITAA 1997 35-35
 - ITAA 1997 35-40
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 - ITAA 1997 35-55
 - ITAA 1997 35-55(1)
 - ITAA 1997 35-55(1)(a)
 - ITAA 1997 35-55(1)(b)
 - ITAA 1997 Div 328
 - ITAA 1997 328-105
 - ITAA 1997 Subdiv 328-F
 - ITAA 1997 Subdiv 328-G
 - TAA 1953 Pt IVA
 - Copyright Act 1968
 - Corporations Act 2001

Case references:

- Commissioner of Taxation v. Lau
 (1984) 6 FCR 202; 84 ATC 4929;
 (1984) 16 ATR 55

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