



PR 2004/50 - Income tax: Paulownia Forestry Scheme

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Product Ruling

Income tax: Paulownia Forestry Scheme

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	18
Explanation	23
Detailed contents list	36

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

Preamble

*The number, subject heading, **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

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 Paulownia Forestry Scheme, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) 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 are more specifically identified in the Ruling part of Product Ruling PR 2001/121 and who, between 14 March 1996 and 14 March 1997, entered into the specified arrangement that is set out in paragraphs 15 to 48 of that Ruling. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling 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. Growers who elect to market their own produce are also excluded from the class of persons to whom this Ruling applies.

Qualifications

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 The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 5 May 2004 for Growers who, between 14 March 1996 and 14 March 1997, entered into the arrangement that is set out in paragraphs 15 to 48 of Product Ruling PR 2001/121.

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 (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, between 14 March 1996 and 14 March 1997, entered into the specified arrangement that is set out in paragraphs 15 to 48 of Product Ruling PR 2001/121. 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 in paragraphs 15 to 48 of Product Ruling PR 2001/121. PR 2001/121 issued on 29 June 2001 ruling to exercise the Commissioner's discretion under paragraph 35-55(1)(b) for the years ending 30 June 2001 to 30 June 2003.

15. Since commencing the Project severe climatic conditions (drought) have caused the Manager to alter the Project outlined in PR 2001/121. The planned clear fell in year 8 (2004) has been altered and a program of felling over 4 years has been introduced. This change was made as a result of an Independent Forester having conducted tests on the Project trees during June/July 2003 for the affect of the severe climatic conditions, and consideration of the recommendations in the subsequent report. The thinnings program, i.e. harvesting 25% of trees each year will result in the yield of the Grower's Woodlot being comparable to that originally forecast.

16. The proposed thinnings program will result in a delay of a further 3 years before the Growers would receive the forecasted full harvest income. However the Grower would receive some income from the first thinning which would now occur in year 9 (2005) with subsequent thinnings to occur each year to year 12 (2008).

17. The initial forecasts were that a Grower with the minimum of one Woodlot would have passed the Assessable Income Test under paragraph 35-30 ITAA in the year ended 30 June 2004. Due to the thinnings program, the Grower with one 0.4 hectare Woodlot should now receive a projected net harvest income in year 9. The Grower would also be achieving a taxation profit for the next three years.

Ruling

Continuing application of Product Ruling PR 2001/121

18. Although now withdrawn, the tax benefits set out in Product Ruling PR 2001/121 continue to apply to participants who are within the specified class of persons to which the Ruling applied and who entered into the specified arrangement between 14 March 1996 and 14 March 1997. This is subject to there being no other material difference in the arrangement, apart from that described in paragraphs 15 to 17 of this Ruling, or in the persons' involvement in the arrangement.

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

Section 35-55 – Commissioner's discretion

19. For a Grower who is an individual and who entered the Project during the years ended 30 June 1996 and 30 June 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)(a) the Commissioner will decide for the income year ending 30 June 2004 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.

20. 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 26 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)).

21. 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.

22. 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) (a) 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

23. 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; or
- 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.

24. 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.

25. 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.

26. 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.

27. 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).

28. 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 Woodlot in the Project would have passed one of the tests in the year ended 30 June 2004 but for 'special circumstances' and is now unlikely to have their activity pass one of the tests until 2007. Growers who acquired more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

29. Therefore, for the income year ending 30 June 2004, 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.

30. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity. 'Special circumstances' are circumstances outside the control of the operators of the business activity, including drought, flood, bushfire or some other natural disaster. Where it can be established that but for the 'special circumstance' the business activity would have passed one of the four tests, the Commissioner may decide that it would be reasonable to exercise the first arm of the discretion in paragraph 35-55(1)(a).

PR 2004/50

31. Information provided with this Product Ruling indicates that a Grower who acquired the minimum investment of one Woodlot in the Project is expected to be carrying on a business activity that, due to 'special circumstances', will not pass the Assessable income test in the year ending 30 June 2004 as originally forecast. The Commissioner will decide for such a Grower that it would be reasonable to exercise the first arm of the discretion for the income year ended 30 June 2004.

32. 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.

33. Product Ruling PR 2001/121 ruled that the Commissioner decided 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 2003.

34. 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 15 to 48 of Product Ruling PR 2001/121 and paragraphs 14 to 17 of this Ruling. If, however, the Project is not carried on during the income years specified above in the manner described in these paragraphs, this Ruling may be affected. Specifically, the decision in relation to paragraph 35-55(1) (a), 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 would then need to apply for private rulings on how paragraph 35-55(1)(a) will apply in such changed circumstances.

35. In deciding that the first arm of the discretion in section 35-55(1) 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 the Responsible Entity.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax laws	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	18
Continuing application of Product Ruling PR 2001/121	18
Division 35 – Deferral of losses from non-commercial business activities	19
<i>Section 35-55 – Commissioner’s discretion</i>	19
Explanation	23
Division 35 – Deferral of losses from non-commercial business activities	23
Detailed contents list	36

Commissioner of Taxation

5 May 2004

PR 2004/50

Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TD 93/34;
TR 97/16; PR 2001/121

Subject references:

- carrying on a business
- commencement of a business
- management fees
- NCL provisions
- primary production
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits

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)
 - TAA 1953 Part IVAAA
 - Copyright Act 1968
-

ATO references

NO 2001/009710
ISSN: 1441-1172