



PR 2004/71 - Income tax: Treecorp Clearwood Project Stage 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *2 June 2004*



Product Ruling

Income tax: Treecorp Clearwood Project Stage 2

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

Preamble

*The number, subject heading, **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 IVA 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.

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 'Treecorp Clearwood Project Stage 2' 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 to 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. 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 (that is, 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;
- persons who participate in the Project through offers made other than through the Product Disclosure Statement; and
- persons who are accepted to participate in the Project after 30 June 2005.

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 2 June 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).

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 dated 27 February 2004, as constituted by documents provided on 27 February 2004, 16 March 2004, 7 May 2004 and 19 May 2004 and additional correspondence dated 16 March 2004, 7 May 2004 and 19 May 2004;
- Draft **Product Disclosure Statement** ('PDS') for the Treecorp Clearwood Project Stage 2, prepared for Treecorp Australia Limited ('TAL') A.C.N. 006 650 880, undated and received 7 May 2004;
- **Constitution** of Treecorp Clearwood Project, dated 25 February 2000, received 19 May 2004;
- Draft **Woodlot Lease** between TAL (as lessor) and the Grower, undated, received 19 May 2004;
- Draft **Woodlot Management Agreement** between TAL and the Grower, undated, received 19 May 2004;
- Draft Plantation Services Agreement between TAL and Treecorp Pty Ltd, undated, received 19 May 2004; and
- Draft Compliance Plan, undated, received 7 May 2004.

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 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. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936. 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.

Overview

17. The salient features of the Treecorp Clearwood Project Stage 2 Project are as follows:

Location	Land on Kangaroo Island, South Australia, which meets Project Land Selection Criteria set out in PDS and Independent Forester's Report
Type of business to be carried on by each participant	Commercial growing and cultivation of "Clearwood" Radiata Pine (<i>Pinus radiata</i>) trees for the purpose of harvesting and selling timber
Number of hectares offered for cultivation	PDS provides for 1000 hectares with an unspecified capacity for oversubscription
Size of each interest	0.5 of a hectare
Minimum allocation	1 Woodlot
Number of trees per hectare	280 approximately (at Clearfell)
Term of the Project	26 Years initial term with a potential to extend the term up to 30 Years
Initial cost	\$4,800 per Woodlot
Initial cost per hectare	\$9,600
Ongoing costs	Insurance premiums as invoiced by the Responsible Entity
Other costs	<ul style="list-style-type: none"> • Fee for Thinnings equal to 100% of the proceeds received from the sale of the Thinnings. • Maintenance fee equal to 4% of the Sales Proceeds after deduction of Harvesting Costs paid when the Grower's Clearfell is sold. • Marketing fee equal to 1% of the Sales Proceeds after deduction of Harvesting Costs paid when the Grower's Clearfell is sold. • Lease rent equal to 3% of the Sales Proceeds after deduction of Harvesting Costs paid when the Grower's Clearfell is sold.

18. The arrangement is called the Treecorp Clearwood Project Stage 2 ('the Project'). The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Treecorp Australia Limited has been issued with an Australian Financial Service Licence and will be the Responsible Entity.

19. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 1000 hectares in the Project and will invite potential 'Applicants' to subscribe for a minimum one-half hectare 'Woodlot' in the Project.

20. To participate in the Project, Applicants must complete the Application and Power of Attorney Form in the PDS and pay the full amount of the 'Application Fee' to the Responsible Entity. By submitting an application, the Applicant will agree to be bound by the Responsible Entity's offer as contained within the PDS, the Constitution, the Woodlot Management Agreement and the Woodlot Lease. TAL has the discretion to accept or refuse an application.

21. Each Applicant who is accepted by TAL to join the Project will become a 'Grower'. Each Grower will enter into a Woodlot Management Agreement and a Woodlot Lease with TAL as the Responsible Entity. The Woodlot Management Agreement and the Woodlot Lease together comprise the 'Project Agreements'.

22. TAL will arrange for the execution of the Project Agreements by 30 June 2004 for each accepted application that it receives on or before 30 June 2004. For each accepted application that TAL receives after 30 June 2004, TAL will arrange for the execution of the Project Agreements on the date it determines.

23. Growers will establish and maintain a commercial plantation of '*Pinus radiata*' (Radiata Pine) trees and carry on a commercial business of afforestation during the term of the Project.

24. TAL will enter into a Plantation Services Agreement with Treecorp Pty Ltd. Under the Plantation Services Agreement, Treecorp Pty Ltd agrees to fulfil the obligations owed by TAL to the Growers under the Woodlot Management Agreement.

Constitution

25. The Constitution establishes the Project and operates as a deed binding the Responsible Entity and each Grower.

26. The Constitution sets out the terms and conditions under which the Responsible Entity will operate and manage the Project and perform the functions conferred on it by this Constitution and the *Corporations Act 2001*. Growers are bound by the Constitution by virtue of their participation in the Project.

27. Under the terms of the Constitution, the Responsible Entity in its absolute discretion, may accept or refuse any Application; clause 6.7. The Application Fee paid by the Applicant will be paid directly to the Responsible Entity and placed in the Application Fund until such time that the Responsible Entity is satisfied that the Application Fee can be released and applied in accordance with the Project Agreements pursuant to clause 5, clause 13 and clause 14. These conditions include TAL being satisfied that the Project Agreements have been duly completed and executed with no outstanding material breaches of the Constitution to the detriment of the Growers.

28. The Responsible Entity must collect, receive and get in all 'Sales Proceeds', being the proceeds from the sale of Thinnings and clear felled trees of the Project, and all proceeds from insurance with respect to each of the 'Grower's Trees'. The Grower's Trees are the trees established on the Grower's Woodlot(s).

29. A Grower is entitled to the money in the 'Proceeds Fund', which represents the gross income from the sale of the Thinnings and the clear felled trees attributable to the Grower's Woodlot(s) and the Grower's proportional interest in any proceeds from insurance with respect to the Grower's Trees less:

- the 'Harvesting Costs', which includes the cost of harvesting, loading and carting each of the Grower's Trees to the mill; clause 18.4 of the Woodlot Management Agreement;
- the Maintenance Fee and the Marketing Fee which are imposed under the Woodlot Management Agreement; and
- the Woodlot Lease Rent, which is imposed under the Woodlot Lease.

30. Among other things the Constitution sets out in detail the following:

- maintenance of the Woodlots, including the Plantation Services Agreement and the engagement of an Independent Forestry Consultant, clause 16, clause 17, clause 18 and clause 19;
- general functions, powers and duties, appointment of agents, and complaints, clause 21, clause 22 and clause 24;
- compliance plan and compliance committee requirement under the *Corporations Act 2001*, clause 25 and clause 26;
- the transfer and transmission of Grower's interest, clause 28 and clause 29;

- the restriction on the Responsible Entity or any of its associates from purchasing the Grower's 'Woodlots' prior to commercial maturity, clause 32;
- the register of Applicants and Growers of the Project, clause 34;
- the retirement and removal of the Responsible Entity, clause 36;
- the expenses of the Responsible Entity for which it cannot be reimbursed from the Proceeds Fund, clause 44; and
- the winding up of the Project and termination of the Project, clause 50 and clause 51.

Compliance Plan

31. As required by the *Corporations Act 2001*, the Responsible Entity has prepared a Compliance Plan for the Project. The Compliance Plan sets out the measures the Responsible Entity must apply in operating the Scheme to ensure compliance with the *Corporations Act 2001* and the Constitution.

Woodlot Lease

32. Upon acceptance of each Application, a Woodlot Lease is executed between TAL as Responsible Entity and the accepted Grower. TAL as lessor agrees to lease the Woodlot(s) identified in the Woodlot Lease to the Grower as lessee. If development approval in relation to the forestry activities to be undertaken on the Woodlots is required and if TAL fails to obtain such approval within 9 months of the execution of the Woodlot Lease, the Responsible Entity will terminate the Woodlot Lease and the Project. The Woodlot Lease is granted upon the terms and conditions outlined in the Woodlot Lease.

33. Under the Woodlot Lease, TAL is entitled to receive Woodlot Lease Rent of 3% of the Sale Proceeds after the deduction of the Harvesting Costs for the term of the Woodlot Lease. The Woodlot Lease will terminate on the earlier of the term specified in the Woodlot Lease, the completion of the harvest of the 'Plantation' or the termination of the Project Agreements in accordance with clause 51 of the Constitution. The Plantation is comprised of all of the trees in the Project.

Woodlot Management Agreement

34. Upon acceptance of each Application, a Woodlot Management Agreement is executed between TAL as Responsible Entity and the accepted Grower. Under the Woodlot Management Agreement, each Grower engages the Responsible Entity to perform the 'Woodlot Management Services' detailed under the agreement. The Woodlot Management Services includes 'Establishment and Development', 'Plantation Maintenance', and the Responsibility Entity acting as agent for each Grower in accordance with clause 14. The Woodlot Management Agreement terminates on the same date as the Woodlot Lease.

35. Each Grower engages the Responsible Entity to perform Establishment and Development services to the Grower's Woodlot(s) within 12 months of the execution of the Woodlot Management Agreement in accordance with appropriate forestry practices. Clause 4 of the Woodlot Management Agreement details the Establishment and Development services, which include:

- ploughing and/or ripping the Woodlots and preparing the Woodlots for planting of Trees;
- supplying and planting 610 trees per hectare; and
- if necessary, applying fertiliser and spraying herbicides to the Grower's Woodlot(s).

36. If the Responsibility Entity makes an assessment that the survival rate of the Plantation is less than 90% within 2 years after the completion of planting, the Responsible Entity will be required to replant sufficient trees to achieve a survival rate of at least 90% in accordance with clause 5.

37. In consideration for performing the services under clause 4 and clause 5, the Responsible Entity is entitled to the Application Fee.

38. Each Grower engages the Responsible Entity to perform Plantation Maintenance to the Grower's Woodlot(s) for the term of the Woodlot Management Agreement. Clause 7 of the Woodlot Management Agreement details the Plantation Maintenance services, which include:

- if necessary, applying fertiliser and spraying herbicides to the Grower's Woodlot(s);
- the maintenance of fire breaks and vehicular access on the Grower's Woodlot(s) and around the Plantation; and
- undertaking regular inspections of the Grower's Woodlot(s).

39. In consideration for performing the services under clause 7, the Responsible Entity is entitled to the Maintenance Fee which is 4% of the Sales Proceeds after the deduction of the Harvesting Costs.

40. The Responsible Entity will undertake 'Thinning' of the trees on each Grower's Woodlot(s). Thinning involves the felling and the removal of the Grower's Trees to reduce the density of the Plantation to 280 trees per hectare. In consideration for undertaking the Thinning the Responsible Entity will receive the full proceeds from the sale of the Thinnings (if any).

41. Under clause 14, each Grower appoints the Responsible Entity as its agent to prune, 'Clearfell', market and sell the Grower's Trees and collect the Sales Proceeds there from. Clearfell is the process of felling and removing the Grower's Trees at commercial maturity. If the Responsible Entity clear fells the trees on the Grower's Woodlot(s) prior to 26 years of planting, the Responsible Entity may only do so if an Independent Forestry Consultant approves the Clearfell as commercially appropriate and in the Grower's best interests.

42. In consideration for performing the services under clause 14, the Responsible Entity is entitled to the Marketing Fee of 1% of the Sales Proceeds after the deduction of the Harvesting Costs.

43. Clause 15 allows the Responsible Entity to purchase the Clearfell from the trees on the Grower's Woodlot(s) at a price determined by an Independent Forestry Consultant which is determined by reference to an open market price at which the trees could be sold at arm's length less a reasonable Harvesting Cost. The Responsible Entity will be entitled to the Marketing Fee even if the Responsible Entity purchases the Clearfell from the trees.

Plantation Services Agreement

44. A Plantation Services Agreement is entered into between TAL as the Responsible Entity and Treecorp Pty Ltd. The parties agree that Treecorp Pty Ltd will provide certain services to the Responsible Entity to enable the Responsible Entity to satisfy its obligations under each Woodlot Management Agreement. The Plantation Services Agreement terminates 12 months after completion of the harvest of the Project, unless otherwise determined by the parties.

45. Treecorp Pty Ltd performs the obligations of the Responsible Entity with respect to the provision of:

- the 'Establishment and Development' services under clause 4 and 5 of each Woodlot Management Agreement;
- 'Plantation Maintenance' under clause 7 of each Woodlot Management Agreement;
- 'Thinning' under clause 8 of each Woodlot Management Agreement; and

- the services under clause 14 of each Woodlot Management Agreement, including pruning, clear felling, marketing and selling the Grower's Trees and collecting the Sales Proceeds there from.

46. Treecorp Pty Ltd during the term of the Project will obtain and maintain professional indemnity insurance for legal liability for any professional act or omission in provision of the services under the Plantation Services Agreement.

Pooling of amounts and distribution of 'Sales Proceeds'

47. The Constitution (Part K) and the Woodlot Management Agreement (clause 17, clause 18 and clause 19) set out provisions relating to the pooling of amounts from the Grower's 'Clearfell' and the distribution of 'Sales Proceeds' less the 'Harvesting Costs' or from insurance proceeds. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Clearfell' or insurance proceeds to the pool making up the 'Proceeds Fund' are entitled to benefit from distributions from the 'Proceeds Fund'; and
- any pooled 'Clearfell' or other 'Sales Proceeds' must consist only of 'Clearfell' or other 'Sales Proceeds' contributed by Growers participating in the Treecorp Clearwood Project Stage 2.

Fees

48. The following fees, per Woodlot, are set out in the Woodlot Management Agreement and the Woodlot Lease:

- \$4,800.00 'Application Fee', payable on application;
- insurance premium as invoiced by the Responsible Entity and payable by the Grower;
- fee for undertaking 'Thinning' equal to the Sales Proceeds for the sale of the Thinnings payable out of the Proceeds Fund;
- 'Maintenance Fee' of 4% of the Sales Proceeds after the deduction of the Harvesting Costs payable out of the Proceeds Fund;
- 'Marketing Fee' of 1% of the Sales Proceeds after the deduction of the Harvesting Costs payable out of the Proceeds Fund; and
- 'Woodlot Lease Rent' of 3% of the Sales Proceeds after the deduction of the Harvesting Costs payable out of the Proceeds Fund.

Finance

49. Growers can fund their involvement in the Project themselves or borrow from an independent lender.

50. Growers who fund their involvement in the Project through borrowing from an independent lender must pay the Application Fee in full when making the Application. Where an application is accepted subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 30 June of the year of application.

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

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

Ruling

Application of this Ruling

52. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Woodlot Management Agreement and a Woodlot Lease:

- on or after the date of the Product Ruling and on or before 30 June 2004 (2004 Growers); and
- on or after 1 July 2004 and on or before 30 June 2005 (2005 Growers).

The Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

53. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

54. 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.

Assessable Income

Section 6-5 and section 328-105

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

56. The Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

57. The Grower who is an 'STS taxpayer' recognises ordinary income from carrying on the business of afforestation at the time that income is received (paragraph 328-105(1)(a)).

Deduction for Application Fee

Section 8-1 and section 328-105

58. In the Table below the 'Application Year' is a reference to

- 30 June 2004 (for 2004 Growers); or
- 30 June 2005 (for 2005 Growers).

59. On a per 'Woodlot' basis, a 2004 Grower or a 2005 Grower may claim a tax deduction for the Application Fee shown in the Table.

60. 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 Grower. Any amount or part of an amount shown in the Table which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Fee Type	'Application Year'	Year 1	Year 2
Application Fee	\$4,800.00 See Notes (i) & (ii)	Nil	Nil

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 101.
- (ii) The Application Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 85 to 89) and is deductible in the income year in which it is incurred (where the Grower is not an 'STS taxpayer') or the year in which it is paid (where the Grower is an 'STS taxpayer').

Interest

61. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling.

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

Section 35-55 – Exercise of Commissioner's discretion

62. A Grower who is an individual accepted into the Project may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10.

63. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending

- **30 June 2004 to 30 June 2034** (for 2004 Growers);
- **30 June 2005 to 30 June 2035** (for 2005 Growers); or
- in both cases, the income year preceding the 'Clearfell' of the Grower's Trees (whichever occurs sooner).

This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

Sections 82KZME to 82KZMF, 82KL and Part IVA

64. For a Grower who participates in the Project and incurs expenditure as required by the Woodlot Management Agreement and the Woodlot Lease the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME to 82KZMF;
- 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?

65. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the Treecorp Clearwood Project Stage 2 must amount to the carrying on of a business of primary production.

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

67. For schemes such as that of the Treecorp Clearwood Project Stage 2, 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.

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

- the Grower has an identifiable interest (by lease) or rights over the land (by licence) on which the Grower's Trees are established;
- the Grower has a right to harvest and sell the wood produce from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

69. In this Project, each Grower enters into a Woodlot Management Agreement and a Woodlot Lease.

70. Under the Woodlot Lease each individual Grower will have rights over a specific and identifiable area of half a hectare of land. The Woodlot Lease provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The lease allows the Responsible Entity to come onto the land to carry out its obligations under the Woodlot Management Agreement.

71. Under the Woodlot Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain one or more Woodlots on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Woodlot(s) on the Grower's behalf.

72. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the Clearfell grown on the Grower's Woodlot(s).

73. 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.

74. 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 Clearfell that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

75. The pooling of Clearfell from trees grown on the Grower's Woodlot(s) with the Clearfell of other Growers in the Treecorp Clearwood Project Stage 2 is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled Clearfell will reflect the proportion of the trees contributed from their Woodlot(s).

76. The Responsible Entity'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.

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

78. 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 Treecorp Clearwood Project Stage 2 will constitute the carrying on of a business.

The Simplified Tax System ('STS')***Division 328***

79. 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.

80. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Application Fee***Section 8-1***

81. Consideration of whether the initial Application Fee is deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

82. The Application Fee 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 the Clearfell) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Application 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***

83. 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 (for example, the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

84. For this Project, only section 82KZL (an interpretive provision) and 82KZMG are relevant.

Section 82KZMG

85. 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).

86. 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.

87. 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.

88. 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. The term 'seasonally dependent agronomic activities' is explained in Taxation Determination TD 2003/12.

89. 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

90. Under the Woodlot Management Agreement, a Grower incurs an initial Application Fee consisting of expenditure of \$4,800.00 per Woodlot for 'seasonally dependent agronomic activities'.

91. As this expenditure will meet all requirements of section 82KZMG, Growers who are not STS taxpayers may claim a deduction in the income year in which the expenditure is incurred. Growers who are STS taxpayers may claim a deduction in the income year in which the expenditure is paid by, or paid for the Grower.

92. Other fees, costs, and charges are outside the scope of this Product Ruling and the application or otherwise of the prepayment provisions are unable to be considered.

Interest deductibility

Section 8-1

93. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier 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.

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

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

Section 35-55 – Exercise of Commissioner’s discretion

95. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years:

- 30 June 2004 to 30 June 2034 (for 2004 Growers);
- 30 June 2005 to 30 June 2035 (for 2005 Growers); or
- in both cases, the income year preceding the ‘Clearfell’ of the Grower’s Trees (whichever occurs sooner);

the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 *Income tax: Division 35 – non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, a Grower’s business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

96. The exercise of the Commissioner’s discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

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

Part IVA – general tax avoidance provisions

98. 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).

99. The Treecorp Clearwood Project Stage 2 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 58 to 60 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.

100. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Clearfell. 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

101. 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).

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Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TR 98/22;
TR 2000/8; TR 2001/14;
TR 2002/6; TR 2002/11;
TD 93/34; 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 82KL
- ITAA 1936 82KZL

- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
- 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
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- 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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