



# ***PR 2005/11 - Income tax: Gunns Plantations Woodlot Project 2005 '2006 Growers'***

 This cover sheet is provided for information only. It does not form part of *PR 2005/11 - Income tax: Gunns Plantations Woodlot Project 2005 '2006 Growers'*

 This document has changed over time. This is a consolidated version of the ruling which was published on *9 February 2005*



## Product Ruling

### Income tax: Gunns Plantations Woodlot Project 2005 '2006 Growers'

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#### **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 Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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.

Potential participants may wish to refer to the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au) or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

## What this Product Ruling is about

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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 'Gunns Plantations Woodlot Project 2005' 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 of the ITAA 1997;
  - section 17-5 of the ITAA 1997;
  - Division 27 of the ITAA 1997;
  - Division 35 of the ITAA 1997;
  - Division 328 of the ITAA 1997;
  - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - sections 82KZME to 82KZMG of the ITAA 1936; and
  - Part IVA of the 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;
- person who finance their participation in the Project through loans with Gunns Finance Pty Ltd other than those loans described at paragraphs 45 to 54 of this Product Ruling;
- Gunns Plantations Ltd or its associates; and
- persons who are accepted to participate in the Project on or before 30 June 2005 and after 30 June 2006.

**Qualifications**

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 The Ruling will be withdrawn or modified.

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## Date of effect

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11. This Ruling applies prospectively from 9 February 2005, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

## Withdrawal

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. 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

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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 19 January 2005 as constituted by documents provided on 22 November 2004, 10 and 23 December 2004, 18 and 19 January 2005 and additional correspondence including emails and telephone conversations dated 19, 20, 21 and 25 January 2005;
- Draft Product Disclosure Statement (PDS) for Gunns Plantations Woodlot Project 2005 received 25 January 2005;
- Draft **Constitution** of the Gunns Plantations Woodlot Project 2005 received 25 January 2005;
- Draft Compliance Plan for the Gunns Plantations Woodlot Project 2005 to be adopted by Gunns Plantations Limited (as Responsible Entity) received 25 January 2005;
- Draft Forestry Right Deed between the owner of the Land (as Landowner) and Gunns Plantations Limited (Gunns Plantations) received 25 January 2005;
- Draft **Forestry Right Lease Deed** between Gunns Plantations Limited (as 'Landlord') and the Grower received 25 January 2005;
- Draft **Lease Agreement Deed** between Gunns Plantations Limited and the Grower received 18 January 2005;
- Draft **Management Agreement** between Gunns Plantations Limited (as Manager) and Gunns Limited and the Grower received 25 January 2005;
- Draft Finance Packages for the Gunns Plantations Woodlot Project 2005 between Gunns Finance Pty Ltd ('Gunns Finance') and Growers entering into the Project by 30 June 2006 as '2006 Growers', received 25 January 2005. These include the **Standard Finance Package**, and the non-standard **Blue Finance Package**, **Red Finance Package** and **Platinum Finance Package**;
- Deed Poll by Gunns Limited in favour of the Growers, received 25 January 2005;
- Draft Wood Sale Agreement between Gunns Plantations Limited (as agent for each Grower) and Gunns Limited, received 25 January 2005; and

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- Draft Amending Agreement to Custody Agreement between Gunns Plantations Limited (as Trustee) and Gunns Limited (as Custodian), received 22 November 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. A Loan Agreement will be executed where a Grower successfully applies for finance from Gunns Finance. 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.

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 Gunns Plantations Woodlot Project 2005 are as follows:

Location	Tasmania
Type of business each participant will be carrying on	Commercial growing of <i>Eucalyptus globulus</i> (Tasmanian Blue-Gum) and <i>Eucalyptus nitens</i> (Shining Gum) trees under one of two Planting Options: <b>Planting Option 1:</b> Pulpwood <b>Planting Option 2:</b> Veneer and Pulpwood
Number of hectares offered for cultivation	5,000 hectares, however, oversubscriptions may be accepted.
Size of each interest	One hectare
Number of trees per hectare	Minimum average of 1,100
Term of the Project	Planting Option 1: 13 years Planting Option 2: 20 years
Initial cost per hectare	'Establishment Fee' of \$6,820
Other costs	Growers will be charged for the cost of any insurance except public liability insurance. A 'Base Line Pruning Fee' will be payable for 'Planting Option 2' in years 4 (\$736), 6 (\$788) and 7 (\$840) per 'Woodlot'. These base costs will be increased in line with CPI. A fee for sales commission, rental and maintenance will be charged at year 9 (that is, at the time of thinning) and at the end of the Project. The fee will equal 9% of the 'Wood Sale Proceeds' from the 'Woodlot'.

18. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Gunns Plantations Limited (Gunns Plantations) has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project.

19. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 5000 hectares in the Project and will invite participants to subscribe for at least one hectare 'Woodlot' in the Project.

20. To participate in the Project participants must complete the 'Application Form' and Power of Attorney Form in the PDS and pay the 'Application Fee'. The 'Application Fee' will be banked into the relevant 'Applications Portion Account' for the respective 'Planting Option' chosen by the Grower. Payment of the 'Application Fee' constitutes full payment of the 'Establishment Fee'. In accordance with clause 7 and 8 of the Constitution these monies will be released to Gunns Plantations when certain specified criteria have been met.

21. Growers will establish and manage a commercial plantation of '*Eucalyptus globulus*' and '*Eucalyptus nitens*' trees and carry on a commercial business of afforestation during the 'Term' of the Project.

22. Growers will enter into a Forestry Right Lease Deed with Gunns Plantations as the 'Landlord'. The Forestry Right Lease Deed will comprise contractual rights in relation to an identifiable area of land called a 'Woodlot'. The Forestry Right Lease Deed will enable Growers to access the land to establish, maintain and ultimately harvest the 'Woodlot'. Growers will also contract with Gunns Plantations as the 'Manager', under a Management Agreement, to have 'Trees' planted on their 'Woodlot(s)' for the purpose of eventual felling and sale in approximately 13 or 20 years, depending on which Planting Option is chosen.

23. The two Planting Options available to Growers are:

***Planting Option 1 Eucalyptus – Pulpwood***

- Either '*eucalyptus nitens*' or '*eucalyptus globulus*' will be planted and maintained for approximately 13 years before being harvested and sold as woodchip logs. Under this option, Growers will receive a thinning payment in approximately year 9.

***Planting Option 2 Eucalyptus – Veneer and Pulpwood***

- Either '*eucalyptus nitens*' or '*eucalyptus globulus*' will be planted and maintained for approximately 20 years before being harvested and sold as both high value hardwood veneer logs and woodchip logs. The 'Trees' will be pruned three times in the first 10 years and will be commercially thinned in approximately year 9.



24. Growers 'Applications' accepted on or after 1 July 2005 and on or before 30 June 2006 will commence participation as '2006 Growers'. **This Ruling only applies in respect of '2006 Growers'. Note that a separate Product Ruling, PR 2005/10 has issued for Growers who enter into the Project from 9 February 2005 to 30 June 2005.**

25. Gunns Plantations has the right to accept oversubscriptions. There is no minimum amount that must be raised under the PDS. The land for the Project will be leased by Gunns Plantations either from Gunns Limited ('Gunns') or a third party land owner. Additional land will be secured if necessary.

## **Constitution**

26. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Forestry Right Deed, Management Agreement, Forestry Right Lease Deed and Draft Wood Sale Agreement are Schedules to the Constitution. These agreements will be executed on behalf of each Grower who has signed the 'Application Form' and 'Power of Attorney Form' in the PDS and who is accepted into the Project. After acceptance and execution of the Agreements, Growers are bound by the Constitution, Forestry Right Lease Deed and Management Agreements by virtue of their participation in the Project. The Responsible Entity will keep a register of Growers accepted into the Project.

## **Compliance Plan**

27. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and the rights of the Growers are protected.

## **Forestry Right Deed and Forestry Right Lease Deed**

28. The Landowner is the registered proprietor of the 'Land' and the Landowner grants to Gunns Plantations the Forestry Right Deed over the 'Land' for the purpose of carrying out the 'Permitted Activities' for the 'Term' of the Project. The Landowner and Gunns Plantations will sign a 'Registration Instrument' and any other document required to enable the Forestry Right Deed, or any rights granted by lease of the 'Forestry Right', to be registered against the title or titles to the 'Land'.

29. Gunns Plantations (as 'Lessor') subsequently leases the 'Forestry Rights' to the Grower under the Forestry Right Lease Deed, to establish, plant, tender, maintain and harvest the 'Trees' for the 'Term' of the Project. The Grower's and Lessor's rights and obligations are set out in clause 4 and 5 respectively. The Grower has, at all times, full right, title and interest in the 'Trees' and the right to have the 'Trees' sold for the benefit of the Grower.

### **Lease Agreement Deed**

30. The Lease Agreement Deed is granted by Gunns Plantations to the Grower upon acceptance of the application where Gunns Plantations is not immediately in a position to grant the Grower a Forestry Right Lease Deed, in respect of the Grower's 'Woodlot'.

31. Gunns Plantations undertakes to take all reasonable steps to grant the Forestry Right Lease Deed in respect of the Grower's 'Woodlot'. It is a requirement of the Australian Financial Services Licence that Gunns Plantations enter into and lodge for registration the Forestry Right Deed within 9 months after the date of the Grower being accepted into the Project. If the Forestry Right Deed is not lodged for registration within 9 months after the issue of interest in the Project to the Grower, Gunns are required to offer the Grower a refund of the 'Application Fee'.

### **Management Agreement**

32. A Management Agreement is entered into between Gunns Plantations (as 'Manager'), Gunns and each Grower. The parties have agreed that the Manager will be appointed to perform the 'Services' in respect of the Grower's 'Woodlot' in accordance with the terms and conditions set out in this agreement. The 'Services' means the 'Establishment Services', the 'Maintenance Services', and the 'Pruning Services'.

33. Growers contract with the Manager to establish and maintain the Growers 'Woodlot' until maturity. The Manager undertakes to use its best endeavours to ensure that all 'Establishment Services' and 'Maintenance Services' are carried out in accordance with good silvicultural practices.

34. Under Clause 4 of the Management Agreement the Manager will provide 'Establishment Services' on each 'Woodlot' within 12 months from the date that the 'Establishment Fee' is paid, or the Manager is first permitted under the Forestry Right Lease Deed to access the land for the purpose of commencing the 'Establishment Services'. However, if that period extends beyond 30 June of the financial year immediately following the year in which the 'Establishment Fee' is paid, the Responsible Entity is to ensure that the 'Establishment Services' will be provided by that 30 June. Clause 5 sets out the 'Maintenance Services' under which the Manager, on behalf of the Grower, must do all things necessary to

rear the 'Trees' and maintain the Grower's 'Woodlots' in accordance with good silvicultural practice.

35. Under clause 6 the Manager will also conduct 'Pruning Services', if required, in accordance with the following guidelines:

- the 'Trees' subject to 'Planting Option 1' will not be pruned; and
- in respect of the 'Trees' subject to 'Planting Option 2', the 'Trees' will be pruned 3 times before such 'Trees' reach approximately 10 years of age.

36. The Manager will be entitled to a 'Maintenance Fee' for providing 'Maintenance Services', which will be deducted by Gunns (as the 'Custodian') on behalf of the Manager from the 'Wood Sale Proceeds' and paid to the Manager in accordance with the Constitution.

37. If requested by the Grower, the Manager will endeavour to procure insurance cover against destruction or damage of the Grower's 'Woodlot' by fire and other usual risks. The Manager will invoice the Grower the relevant insurance premium together with an administration charge of 10% of the amount of the premium in each year or part thereof.

38. The Manager will be responsible for insuring the 'Plantation' against public risk for an amount of not less than \$10,000,000.

39. Growers will appoint Gunns Plantations, acting as their agent, to sell the timber produce on the Grower's behalf for the prevailing market price to Gunns, but subject to the floor price (clause 5 of the Draft Wood Sale Agreement).

## **Deed Poll**

40. The Manager will enter into a Deed Poll with Gunns whereby Gunns will agree to purchase the 'Harvested Wood' for the 'Purchase Price' which is fair and reasonable having regard to several factors including the market price of similar wood and its quality. These factors are set out in clause 5 of the Draft Wood Sale Agreement.

## **Fees**

41. Under the Management Agreement the 'Establishment Fee' payable for the 'Establishment Services' is \$6,820.

42. There are no ongoing fees for rent or maintenance charges. A single fee for sales commission, lease and maintenance will be payable at year 9 (that is, at the time of thinning) as well in year 13 or 20 depending on the 'Planting Option' taken. The single fee will equal 9% of the 'Wood Sale Proceeds' from the 'Woodlot'.

43. A 'Base Line Pruning Fee' will be payable for 'Planting Option 2' in years 4 (\$736), 6 (\$788) and 7 (\$840) per 'Woodlot'. This Base Line Pruning Fee' will be increased in-line with the 'Consumer Price Index'.

#### **Pooling of 'Trees' and distribution of proceeds**

44. The Constitution sets out the circumstances relating to the pooling of Growers' 'Trees' and the distribution of proceeds from that sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Trees' from a 'Harvested Woodlot' to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and
- 'Trees' can only be pooled with the 'Trees' of Growers accepted to participate in the Gunns Plantations Woodlot Project 2005 on or after 1 July 2005 and on or before 30 June 2006.

#### **Finance**

45. A number of finance packages will be offered on commercial terms by Gunns Finance. Growers, (called 'Borrowers' in the Finance Packages), can borrow from Gunns Finance provided that the conditions precedent in clause 3 of Part B of the 'Loan Terms' are satisfied.

46. Growers cannot rely on this Product Ruling if they enter into a finance package with Gunns Finance that materially differs from those provided to the Tax Office by Gunns Plantations with the application for this Product Ruling. These finance packages are summarised below.

47. Common features contained in each of these finance packages are that:

- the Grower's application to participate in the Project has been accepted by Gunns Plantations;
- the Grower pays a loan 'Establishment Fee' of \$150;
- Gunns Finance will take security over the Growers 'Woodlot';
- additional 2% interest per annum applies to overdue amounts due and payable; and
- additional or 'break' costs of \$400 will apply when a loan is repaid early.

48. At the absolute discretion of Gunns Finance:
- the deposit required under the Standard Finance Package may vary from 10% to 30% of the 'Application Fee'; and
  - the interest rates shown below for both the Standard and Non-Standard Finance Packages, may be varied.

49. The Grower agrees to repay the 'Loan', and pay interest and all other 'Outstanding Monies' to Gunns Finance. The Grower will pay the 'Repayment Amount' on the 'Repayment Date' of each month during the 'Term' of the 'Loan' as detailed in Part D – Loan Schedule.

50. The Grower may repay the 'Outstanding Balance' in whole or in part in any time. However, where the loan is repaid early the Grower will pay to Gunns Finance the amount determined by Gunns Finance under clause 6.2 of the 'Loan Term'.

51. The specific features of the finance arrangements Growers may enter into are as follows:

**Standard Finance Package:**

**Principal only loan:**

- Growers will be entitled to elect to enter into a non-interest bearing loan with Gunns Finance; and
- Growers who enter into this finance arrangement will be required to pay a deposit of at least 10% of the 'Application Fee' and make 12 equal monthly repayments of the balance.

**Principal and interest loans:**

- the 'Term' of the 'Loan' is for 3, 5 or 10 years;
- an initial deposit equal to 20% of the 'Application Fee' applies;
- an interest rate of 10.5%. For 10 year loans the interest rate will be reviewed after 5 years and fixed at 4% points above the ANZ Banking Group Ltd's 5 year swap reference rate;
- 'Repayment Amounts' are due as per Item 5 of the Loan Schedule and the Part J Woodlot Project Repayment Schedule; and
- Growers who enter into these finance arrangements will be required to make equal monthly repayments of the balance over the 'Term' of the 'Loan'.

**Non-Standard Finance Packages:****Red Finance Package:**

- the 'Term' of the 'Loan' is 9 years;
- Growers using this finance option must subscribe for a minimum of 5 'Woodlots';
- an initial deposit of at least 10% of the 'Application Fee' applies;
- Growers pay a further 20% of the 'Application Fee' by 30 September in the following financial year;
- repayment of the outstanding principal occurs in year 9;
- payments of interest are due and payable on the last day of each month. 'Repayment Amounts' are due in accordance with item 5 of the Loan Schedule and the Part J Repayment Schedule; and
- an interest rate of 10.5% applies for the first 5 years. The interest rate will subsequently be reviewed every 5 years and fixed at 4% points above the ANZ Banking Group Ltd's 5 year swap reference rate.

**Platinum Finance Package:**

- the 'Term' of the 'Loan' is for 10 years;
- an initial deposit of at least 20% of the 'Application Fee' applies;
- 60 equal interest only payments (in arrears) followed by 60 principal and interest repayments. 'Repayment Amounts' are due in accordance with Item 5 of the Loan Schedule and the Part J Repayment Schedule; and
- an interest rate of 10.5% applies for the first 5 years. The interest rate will subsequently be reviewed every 5 years and fixed at 4% points above the ANZ Banking Group Ltd's 5 year swap reference rate.

**Blue Finance Package:**

- the 'Term' of the 'Loan' is for 13 years and 20 years for Planting Options 1 and 2 respectively;
- Growers using this finance option must subscribe for a minimum of 5 'Woodlots';
- an initial deposit of at least 50% of the 'Application Fee' applies;

- 'Repayment Amounts' are due in accordance with Item 5 of the Loan Schedule and the Part J Repayment Schedule;
- for 'Planting Option 1' repayments of principal will occur in two instalments, year 9 and year 13 of the Project;
- for 'Planting Option 2' repayments will occur in year 9 and year 20 of the Project; and
- an interest rate of 9.9% applies for the first 5 years. The interest rate will subsequently be reviewed every 5 years and fixed at 4% points above the ANZ Banking Group Ltd's 5 year swap reference rate.

52. '2006 Growers' cannot rely on any part of this Product Ruling if the 'Application Fee', other than an 'Application Fee' payable subject to a finance arrangement, is not paid in full by 30 June 2006.

53. Where Gunns Plantations accepts applications subject to finance approval, '2006 Growers' cannot rely on this Ruling if written evidence of that approval has not been given to Gunns Plantations by the relevant lending institution on or before 30 June 2006.

54. This Ruling also 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, other than Gunns Finance, are involved or become involved in the provision of finance to Growers for the Project.

## **Ruling**

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### **Application of this Ruling**

55. Subject to paragraph 8, this Ruling applies only to Growers who are accepted to participate in the Project on or after 1 July 2005 and on or before 30 June 2006 as a '2006 Grower' and who have executed a Management Agreement and either a Lease Agreement Deed or a Forestry Right Lease Deed on or before that date.

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

57. 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***

58. 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**

59. 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**

60. 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.

61. 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.

62. 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)).

**Deductions for the 'Establishment Fee' and for interest****Section 8-1 and section 328-105**

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

64. 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. For Growers who are 'STS Taxpayers', 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.

<b>Fee Type</b>	<b>Year ended 30 June 2006</b>	<b>Year ended 30 June 2007</b>	<b>Year ended 30 June 2008</b>
<b>'Establishment Fee'</b>	\$6,820 See Notes (i) & (ii)		
<b>Interest on loans with Gunns Finance</b>	As incurred <b>(Non-STS taxpayers)</b> Or as paid <b>(STS taxpayers)</b> See Notes (iii) & (iv)	As incurred <b>(Non-STS taxpayers)</b> Or as paid <b>(STS taxpayers)</b> See Notes (iii) & (iv)	As incurred <b>(Non-STS taxpayers)</b> Or as paid <b>(STS taxpayers)</b> See Notes (iii) & (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 (for example input tax credits): Division 27. See Example 1 at paragraph 103.
- (ii) Under section 82KMG the 'Establishment Fee' is expenditure for 'seasonally dependent agronomic activities' (see paragraph 90 to 93) 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'**).
- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Gunns Finance Pty Ltd is outside the scope of this Ruling. Growers who borrow from lenders other than Gunns Finance Pty Ltd may request a private ruling on the deductibility of the interest incurred.
- (iv) This Ruling does not apply to Growers who choose or who are required to prepay interest under a loan agreement (including loans from lenders other than Gunns Finance Pty Ltd). All Growers, who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 88 to 96 as those rules may be applicable if interest is prepaid. Any Grower who prepays interest may request a private ruling on the taxation consequences of their participation in the Project.

**Division 35 – deferral of losses from non-commercial business activities*****Section 35-55 – exercise of Commissioner's discretion***

65. A Grower who is an individual accepted into the Project on or after 1 July 2005 and on or before 30 June 2006 as a '2006 Grower' may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. 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 Growers who participate under one or both of the 'Planting Options':

- 'Planting Option 1' for the income years ending 30 June 2006 to 30 June 2019 or the income year preceding the 'Harvest' of the Grower's 'Trees' (whichever occurs sooner); and/or
- 'Planting Option 2' for the income years ending 30 June 2006 to 30 June 2026 or the income year preceding the 'Harvest' 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, 82KZMF and 82KL and Part IVA**

66. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Forestry Right Lease Deed 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 and 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**

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### **Is the Grower carrying on a business?**

67. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the Gunns Plantations Woodlot Project 2005 must amount to the carrying on of a business of primary production.

68. Where there is a business, or a future business, the gross proceeds from the sale of the 'Wood' 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.

69. For schemes such as that of the Gunns Plantations Woodlot Project 2005, 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.

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

- the Grower has an identifiable interest in land (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' 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.

71. In this Project, each Grower enters into a Management Agreement and a Forestry Right Lease Deed, and in some situations, where land is not immediately available, a Lease Agreement Deed.

72. Under the Forestry Right Lease Deed each individual Grower will have rights over a specific and identifiable area of approximately one hectare of land. The Forestry Right Lease Deed provides the Grower with an ongoing interest in the specific trees on the leased area for the 'Term' of the Project. Under the 'Forestry Right' the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The 'Forestry Right' allows the Manager to come onto to the land to carry out its obligations under the Management Agreement.

73. Under the Management Agreement the 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 Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the 'Services' to establish and maintain the 'Woodlot' on the Grower's behalf.

74. The Manager is also engaged to harvest and sell, on the Grower's behalf, the 'Wood' grown on the Grower's 'Woodlot'.

75. 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.

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

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

78. The 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.

79. The Grower's degree of control over the Manager as evidenced by the Management 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.

80. 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 Gunns Plantations Woodlot Project 2005 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

81. 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.

82. 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 'Establishment Fee' and interest**

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

83. Consideration of whether the 'Establishment 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.

84. The 'Establishment 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 'Wood') 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 'Establishment Fee'. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Interest deductibility**

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

##### *(i) Growers who use Gunns Finance Pty Ltd as the finance provider*

85. Some Growers may finance their participation in the Project through a loan facility with Gunns Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the 'Establishment Fee' under the Management Agreement.

86. The interest incurred for the year ended 30 June 2006 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations 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.

##### *(ii) Growers who DO NOT use Gunns Finance Pty Ltd as the finance provider*

87. 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 Gunns Finance Pty Ltd 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.

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

88. 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.

89. For the Arrangement that applies to this Product Ruling, only sections 82KZL (an interpretive provision) and 82KZMG are relevant (but see paragraphs 94 to 95 for comments on the possible application of sections 82KZME and 82KZMF).

***Section 82KZMG***

90. Expenditure that meets the requirements of section 82KZMG is excluded from the application of the prepayment rules that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure incurred under a plantation forestry managed agreement. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees. Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of its eligible service period (as defined in subsection 82KZL(1)), and by the end of the following income year.

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

91. Under the Management Agreement, a Grower incurs an initial 'Establishment Fee' consisting of expenditure of \$6,820 that:

- is for 'seasonally dependent agronomic activities'; and
- meets the other requirements of section 82KZMG.

92. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the expenditure in the income year in which the fee is incurred.

93. A Grower who is an 'STS taxpayer' can claim an immediate deduction for this expenditure in the income year in which the amount is paid. Where the 'Establishment Fee' of a Grower who is an 'STS taxpayer' is not wholly paid in the year in which it is incurred it is only deductible in that year to the extent to which it is paid by, or paid for the Grower.

*Sections 82KZME and 82KZMF*

94. Under the Arrangement to which this Product Ruling applies fees for rent under the Forestry Right Lease Deed and the Maintenance Fee and the Sales Commission payable under the Management Agreement are only payable as a percentage of the proceeds from the harvest and sale of the 'Trees', or from insurance proceeds. Interest payable under each of the finance packages offered by Gunns Finance is incurred and payable monthly in arrears or annually in arrears, as the case may be. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement.

95. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project chose to prepay interest under a finance agreement with Gunns Finance or chose or is required to prepay interest under a loan agreement with a lender other than Gunns Finance. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

96. Growers who choose to prepay interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

**Division 35 – deferral of losses from non-commercial business activities*****Section 35-55 – exercise of Commissioner's discretion***

97. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 65 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.



98. 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**

99. 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**

100. 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).

101. The Gunns Plantations Woodlot Project 2005 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 63 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.

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

103. 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**

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

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**Commissioner of Taxation**

9 February 2005

<i>Previous draft:</i>	TR 2002/11; TD 93/34;
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<i>Related Rulings/Determinations:</i>	<i>Subject references:</i>
PR 1999/95; PR 2005/10;	- advance deductions and expenses for certain forestry expenditure
TR 92/1; TR 92/20; TR 97/11;	- carrying on a business
TR 97/16; TR 98/22; TR 2000/8;	- commencement of business
TR 2001/14; TR 2002/6;	

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- fee expenses
  - forestry agreement
  - interest expenses
  - management fees
  - non-commercial losses
  - producing assessable income
  - product rulings
  - public rulings
  - seasonally dependent agronomic activity
  - tax avoidance
  - tax benefits under tax avoidance schemes
  - tax shelters
  - tax shelters project
  - taxation administration
- Legislative references:*
- ITAA 1936 82KL
  - ITAA 1936 Pt III Div 3 Subdiv H
  - ITAA 1936 82KZL
  - ITAA 1936 82KZL(1)
  - ITAA 1936 82KZM
  - ITAA 1936 82KZMA
  - ITAA 1936 82KZMB
  - ITAA 1936 82KZMC
  - ITAA 1936 82KZMD
  - ITAA 1936 82KZME
  - ITAA 1936 82KZMF
- ITAA 1936 82KZMG
  - 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 IVAAA
  - 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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