

PR 2005/14 - Income tax: FEA Plantations Project 2005 - 2006 Growers

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *2 November 2005*



Product Ruling

Income tax: FEA Plantations 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.*

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

No guarantee of commercial success

Potential participants may wish to refer to the Tax Office website at 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.

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.

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 'FEA Plantations 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);
- section 82KZL of the 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 1 July 2005 and on or before 30 June 2006. 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;
- Forest Enterprises Australia Ltd ('FEA Ltd') or its associates;
- persons who finance their participation in the Project through loans with FEA Ltd other than those described at paragraphs 42 to 48 of this Product Ruling; and
- persons who are accepted to participate in the Project prior to 1 July 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

11. This Ruling applies prospectively from 16 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).

Note: The Addendum to this Ruling that issued on 2 November 2005, applies on and from 1 July 2005.

Withdrawal

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

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

- Application for a Product Ruling as constituted by documents provided on 4 and 31 January 2005 and additional correspondence, including e-mails received 31 January, 7 and 8 February 2005;
- Draft **Product Disclosure Statement** ('PDS') for the FEA Plantations Project 2005 issued by FEA Plantations Limited ('FEA Plantations') the 'Responsible Entity', received by the Tax Office 31 January 2005;
- The draft **Constitution** establishing the FEA Plantations Project 2005 ('the Constitution'), received by the Tax Office 4 January 2005;
- Draft Transfer Creating Profit À Prendre or Forestry Right between the Landowner and FEA Plantations, received by the Tax Office 4 January 2005;
- The **Forestry Right Lease Deed**, ('the Lease'), to be entered into by each Grower and FEA Plantations ('the Lessor'), received by the Tax Office 4 January 2005;
- The draft **Management Agreement**, to be entered into by each Grower and FEA Plantations ('the Manager'), received by the Tax Office 4 January 2005;
- The draft **Loan Agreement** which may be entered into by each Grower and Forest Enterprises Australia Limited ('FEA Ltd') an entity associated with FEA Plantations, received by the Tax Office on 4 January 2005;
- The Custodian Agreement between FEA Plantations and Tasmanian Perpetual Trustees Limited ('the Custodian') received by the Tax Office 4 January 2005;
- The Draft Compliance Plan for FEA Plantations Project 2005 issued by FEA Plantations, received by the Tax Office 4 January 2005; and
- Draft Wood Purchase Agreement between FEA Plantations and FEA Ltd, received by the Tax Office 4 January 2005.

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.

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 FEA Plantations Project 2005 arrangement are as follows:

Location	Tasmania and areas of New South Wales and Queensland.
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Eucalyptus nitens</i> (Shining Gum) and similar species, for the purpose of harvesting and selling timber.
Number of hectares offered	Approximately 3,000, with capacity for oversubscription.
Size of each interest	0.5 hectare (one 'Woodlot')
Minimum allocation	One Woodlot per Grower
Number of trees per 'Woodlot'	Minimum of 600 trees
Term of the Project	13 years
Initial cost per 'Woodlot'	\$3,300 for Establishment Services
Ongoing costs	Deferred 'Management Fee' and deferred 'Rent' will be a percentage of 'Net Harvest Proceeds' or from insurance proceeds where the 'Plantation Crop' is damaged or destroyed.
Other costs	<ul style="list-style-type: none"> • Marketing and harvesting costs will be retained from the 'Harvest Proceeds' on a proportional basis; • Insurance premiums; and • Loan interest.

18. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. A Custodian has been appointed under the Custodian Agreement to protect the interests of the Growers in their dealings with FEA Plantations.

19. The minimum area of 'Land' that can be leased by a Grower under the Project is one 'Woodlot' of 0.5 of a hectare. Plantations in this Project will be established close to other existing plantation holdings that the Forest Enterprises Group has established in Tasmania, northern New South Wales and Queensland. Other regions of Australia with suitable climate, soils and strategic advantages may be included if advice from the Independent Forester approves their inclusion. All plantations for use in this Project will be established on land with well structured soils. All properties chosen are situated:

- in an area with a mild climate and uniform rainfall throughout the year;
- near major arterial routes and major ports with loading facilities; and
- above low lying flat land prone to flooding.

20. Each Grower will be granted by, and take from the Responsible Entity a lease of a 'Forestry Right' in a 'Woodlot' under the Forestry Right Lease Deed for the purpose of cultivating and nurturing 'Trees', and harvesting timber. The Grower's rights under the Forestry Right Lease Deed will include the right to enter and exclusively use the 'Woodlot' allocated to the Grower including the right to plant, cultivate, manage and harvest 'Trees' on that 'Land' and to sever, take away and sell the 'Timber'.

21. The Growers will also enter into a Management Agreement with FEA Plantations to have suitable Eucalyptus seedlings planted on their 'Woodlot' for the purposes of thinning at approximately 9 years and clearfell at approximately 13 years. FEA Plantations will establish the 'Woodlot' during the optimal planting season but no later than 12 months after the acceptance of the application.

22. Under the Management Agreement, FEA Plantations will also cultivate the Grower's 'Trees' and be responsible for harvesting, processing and selling the Grower's 'Timber'.

23. The 'Net Harvest Proceeds' is the amount received at thinning and clearfelling for the 'Timber' on the plantation 'Woodlots' in the Project. From the 'Net Harvest Proceeds' will be deducted each Grower's proportionate share of the Project expenses, their respective 'Rent' under the Forestry Right Lease and their 'Management Fees' under the Management Agreement. The amount remaining will be the net 'Harvest Proceeds' distributable to Growers. Distributions to Growers will be based on the percentage that their 'Woodlots' bears to the total number of 'Woodlots' in the Project.

24. If requested to do so by a Grower, FEA Plantations will endeavour to procure insurance cover against destruction or damage of the Grower's 'Woodlot' by fire and other usual risks. The Responsible Entity 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. Insurance will be compulsory for Growers who obtain finance for their investment from FEA Ltd. Growers may elect to arrange their own insurance.

25. Growers will receive an annual report from the Independent Forester and FEA Plantations summarising the progress of plantations in the Project. The report from FEA Plantations will cover:

- compliance with the arrangement as described in the Product Ruling;
- compliance with any changes to the tax laws subsequent to the issue of the Product Ruling and any significant changes to the market which may impact product marketing; and
- any changes to fees.

26. The Project will conclude upon final harvest of the 'Trees' and the sale of the 'Timber'. The thinning of plantations is scheduled to occur about 9 years from planting, where approximately half the 'Trees' will be harvested.

Constitution

27. The Constitution establishes the Project and operates as a deed binding all of the Growers and FEA Plantations. The Constitution sets out the terms and conditions under which FEA Plantations agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

28. An applicant for an Interest in the Project must complete an application in the form and manner approved by the Responsible Entity. Clause 10 provides that the application must:

- be accompanied by payment of the amount due to, and in the form required by, the Responsible Entity for an Interest in the Project;
- include an irrevocable and binding authority by the applicant to enter into the Forestry Right Lease and Management Agreement, in the form in Schedule 2 and Schedule 3 of the Constitution or in such other form and content as the Responsible Entity determines from time to time;
- include a power of attorney in favour of the Responsible Entity; and
- be accompanied by such other information and documents and in such forms as the PDS may require.

29. Under the terms of the Constitution, all moneys received from applications shall be paid to FEA Plantations. FEA Plantations shall, within a reasonable time or at time of the receipt of the 'Application Money', forward the payment to the Custodian. FEA Plantations must ensure that the Custodian deposits 'Application Money' into a trust account designated in accordance with section 1017E of the *Corporation Act 2001*. The 'Application Moneys' will be released by

the Custodian when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 11).

30. When an applicant becomes a Grower, the Responsible Entity must immediately enter in the 'Register' all relevant details of the Grower and their 'Land', within 9 months after the issue of an interest in the Project to that Grower. Entry on the 'Register' is conclusive of a Grower's right to an interest in the Project (clause 13).

31. In summary, the Constitution also sets out provisions relating to:

- FEA Plantation's powers and duties, (clause 3) including the power to execute all documents on the Grower's behalf, (clause 3.1);
- termination of the Project (clause 5);
- the right of FEA Plantations to be paid fees and other expenses (clause 6);
- the Grower's right to request a withdrawal where a Forestry Right Lease cannot be granted within 9 months (clause 11.6);
- the registration of the Forestry Right (clause 12.5);
- the assignment of the Grower's interest in the Project (clause 14);
- proceeds of harvest and distributions (clause 18);
- insurance proceeds (clause 19); and
- default by Growers (clause 20).

Compliance Plan

32. As required by the *Corporations Act 2001*, FEA Plantations has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that FEA Plantations manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Management Agreement

33. Under the Management Agreement, Growers contract with the Manager to establish and maintain a plantation of 'Trees' on their leased area of 'Land' until maturity (after thinning at approximately nine years). At maturity, the 'Trees' will be harvested and the 'Timber' sold on behalf of the Grower.

34. The Manager will provide the 'Plantation Establishment Services' described in clause 1 of the agreement. The 'Plantation Establishment Services' shall commence as soon as practical after the date of execution of the Management Agreement being the date on which the Grower's application is accepted ('Agreement Commencement Date'). The Manager will use its best endeavours to complete all 'Plantation Establishment Services' within 12 months of the commencement of the 'Plantation Establishment Services' (clause 2).

35. Under clause 3 the Manager will provide 'Management Services' related to the tending and rearing of the seedlings and the management and maintenance of the plantation established on the 'Land'.

36. In the event that a Grower's plantation suffers damage and it is not economic to nurture the plantation to harvest, the Management Agreement will come to an end as at the date of destruction. The only obligation remaining on the parties will be the obligation of the Grower under the Constitution to pay 'Deferred Fees' (which includes the 'Management Fees'). The 'Deferred Fees' will crystallise on the date of destruction and thereupon become due and payable (clause 15).

37. On behalf of the Grower the Manager will determine the appropriate time for the thinning and clearfell of the Grower's 'Trees' and will market and sell the Grower's 'Timber'.

Forestry Right Lease Deed

38. Growers grant a Power of Attorney to FEA Plantations to execute a Lease of a Forestry Right on their behalf. The Lease of the Forestry Right is for a specified area of 'Land' on which the Grower's plantation will be established.

39. Under this Lease the Grower agrees to pay to the Lessor the 'Rent' for the lease of the specified area of 'Land' for the term of the lease period. The term of the Lease is from the date of the allocation of the Land by FEA Plantations, until the clearfell of 'Trees' on the 'Land'.

Fees

40. The following fees, per 'Woodlot', are set out in the Management Agreement and Forestry Right Lease Deed:

- \$3,300, payable on application for the 'Plantation Establishment Services' to be provided within 12 months of the Grower's application being accepted;
- 'Rent' of 12% of the 'Net Harvest Proceeds';
- a 'Management Fee' of 3% of the 'Net Harvest Proceeds'; and
- other fees and costs set out in the Table above.

Harvesting and sale of pooled of 'Timber'

41. The PDS and clause 18 of the Constitution set out the circumstances relating to the harvest, sale and pooling of Growers' 'Timber' and distribution from the 'Proceeds Fund'. Distributions from the Proceeds Fund (as diminished by deductions and insurance proceeds) will be on a pro rata basis according to the ratio that the Grower's 'Woodlot(s)' bear to the total 'Woodlots' of the Project. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Timber' to the pool making up the 'Proceeds Fund' are entitled to benefit from distributions from the 'Proceeds Fund'; and
- 'Timber' can only be pooled with the 'Timber' of Growers accepted to participate in the FEA Plantations Project 2005.

Finance

42. Growers can fund their involvement in the Project by borrowing from FEA Ltd (a lender associated with FEA Plantations), or borrow from an independent lender.

43. Growers are able to borrow from FEA Ltd an amount equal to their full application fee less a minimum deposit of 10%. FEA Ltd provides the loan on a full recourse basis and recovery action will be taken in respect of any default by the borrower. Overdue repayments will incur interest at the default rate of 15% per annum.

44. Standard terms for the finance are, as follows:

- One year interest free – repayable by 12 monthly instalments.
- Three years at fixed interest of 9.5% per annum, repayable by monthly instalments over the term of the loan.
- Five years at fixed interest of 10.0% per annum, repayable by monthly instalments over the term of the loan.
- Seven years at fixed interest of 10.5% per annum, repayable by monthly instalments over the term of the loan.
- Ten years at fixed interest of 11.0% per annum, repayable by monthly instalments over the term of the loan. The ten year loan is only available to Growers with a minimum of 10 'Woodlots'.

45. The security for the loan is provided by the assignment to FEA Ltd, over the term of the loan, of the Grower's rights and interest in the Management Agreement and the trees planted under it, and every other document, interest or right held in connection with the cultivation of the trees including the Lease Agreement.

46. This Product Ruling does not cover financing arrangements, other than those set out in paragraphs 43 and 44. Growers who enter into finance agreements not covered by this Product Ruling may request a private ruling on the deductibility or otherwise of interest incurred under the agreement.

47. Growers cannot rely on any part of this Product Ruling if Application Monies otherwise remain unpaid by 30 June 2006. A Grower cannot rely on this Ruling if FEA Plantations accepts their application subject to finance approval by any lending institution, including FEA Ltd, and written evidence of that approval has not been given to FEA Plantations by 30 June 2006.

48. 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, other than with Forest Enterprises Australia Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

49. 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 and who have executed a Management Agreement and Forestry Right Lease Deed on or between those dates. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

50. This Ruling does **not** apply to Growers who:

- are excluded from the Ruling as described in the Class of Persons or the Arrangement sections of this Product Ruling; or
- are accepted to participate in the Project on or before 30 June 2005 or on or after 1 July 2006.

51. 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

52. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. Changes to the STS rules apply from 1 July 2005. From that date, STS taxpayers may use the accruals accounting method. For a Grower participating in the Project, the recognition of income and the timing of tax deductions under the STS where the Grower uses the cash accounting method is different.

Qualification

53. 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**

54. 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.

55. Other than Growers referred to in paragraph 56, a Grower is assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is derived.

56. A Grower who is an 'STS taxpayer' using the cash accounting method is assessable on ordinary income from carrying on their business of afforestation at the time the income is received.

Deductions for the 'Plantation Establishment Services' fee, and interest**Section 8-1 and section 328-105**

57. A Grower may claim, on a per Woodlot basis, tax deductions for the following revenue expenses.

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
'Plantation Establishment Services'	\$3,300 See Notes (i) & (ii)	nil	nil
Interest payable to FEA Ltd under Loan Agreements	As incurred (Non-STS taxpayers & STS taxpayers using accruals accounting) Or as paid (STS taxpayers using cash accounting) See Notes (iii) & (iv)	As incurred (Non-STS taxpayers & STS taxpayers using accruals accounting) Or as paid (STS taxpayers using cash accounting) See Notes (iii) & (iv)	As incurred (Non-STS taxpayers & STS taxpayers using accruals accounting) Or as paid (STS taxpayers using cash accounting) 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 the Example at paragraph 96.
- (ii) Under section 82KZMG the Plantation Establishment Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraph 84) and is deductible in the income year in which it is incurred (where the Grower is **not an 'STS taxpayer or an STS taxpayer' using the accruals accounting method'**) or the year in which it is paid (where the Grower is an **'STS taxpayer using the cash accounting method'**).
- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than FEA Ltd is outside the scope of this Ruling. Growers who borrow from lenders other than FEA 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 FEA Ltd). All Growers, who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 87 to 89 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 – Commissioner's discretion

58. A Grower who is an individual accepted into the Project during the financial year ended 30 June 2006 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 these Growers for the income years ending:

- **30 June 2006 to 30 June 2018;** or
- the income year preceding the 'Harvest Year' (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

59. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement, the Lease Agreement and any Loan Agreement (as applicable) 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

Is the Grower carrying on a business?

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

61. Where there is a business, or a future business, the gross proceeds from the sale of the 'Timber' will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

62. For schemes such as that of the FEA Plantations 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.

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

- the Grower has an identifiable interest in the 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 'Timber' from those 'Trees';
- the afforestation activities are carried out on the Grower's behalf;

- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

64. In this Project, each Grower enters into a Management Agreement and a Forestry Right Lease.

65. Under the Forestry Right Lease each individual Grower will have rights over a specific and identifiable area of 0.5 of a hectare of 'Land'. The Forestry Right Lease 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 Lease the Grower must use the 'Land' in question for the purpose of carrying out afforestation activities and for no other purpose. The Forestry Right Lease allows the Manager to come onto the 'Land' to carry out its obligations under the Management Agreement.

66. 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 establish and maintain the 'Woodlot' on the Grower's behalf.

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

68. 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.

69. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the 'Timber' that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

70. The pooling of 'Timber' from 'Trees' grown on the Grower's 'Woodlot' with the 'Timber' of other Growers in the Project is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled 'Timber' will reflect the proportion of the 'Trees' contributed from their 'Woodlot'.

71. 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.

72. The Grower's degree of control over the Manager as evidenced by the Constitution, 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 plantations and the activities carried out on

the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

73. 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 FEA Plantations Project 2005 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

74. 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.

75. 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 the 'Plantation Establishment Services' fee

Section 8-1

76. Consideration of whether the fee for 'Plantation Establishment Services' 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.

77. The fee for 'Plantation Establishment Services' payable under the Management Agreement is associated with the Grower's afforestation activities. It will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a

sufficient connection to the operations by which income (from the harvesting and sale of 'Timber') is to be gained from this business. It 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. The fee for 'Plantation Establishment Services' does not include a capital component. 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 pay fees under a Loan Agreement with FEA Ltd

78. Some Growers may finance their participation in the Project through a Loan Agreement with FEA 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 fee for 'Plantation Establishment Services' under the Management Agreement.

79. The interest incurred will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of trees – 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 in the income year in which it is incurred (where the Grower is not an 'STS taxpayer or an 'STS taxpayer' using accruals accounting method') or the income year in which it is paid (where the Grower is an 'STS taxpayer using cash accounting method').

(ii) Growers who enter into finance arrangements with other finance providers

80. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance facility with a bank or financier other than FEA 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

81. 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.

82. For this Project, only section 82KZL (an interpretive provision) and section 82KZMG are relevant, (but see paragraphs 87 and 88 for comments on the possible application of sections 82KZME and 82KZMF).

Section 82KZMG

83. 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 a 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

Section 82KZMG

84. Under the Management Agreement, a Grower incurs a fee for 'Plantation Establishment Services' of \$3,300 per Woodlot that:

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

85. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the fee for 'Plantation Establishment Services' in the income year in which the amount is incurred.

86. A Grower who is an 'STS taxpayer' can claim an immediate deduction for the fee for 'Plantation Establishment Services' in the income year in which the fee is paid. Where the fee is not wholly paid in the year in which it is incurred it is only deductible in that year to the extent it is paid by, or paid for the Grower.

Sections 82KZME and 82KZMF

87. Under the Arrangement to which this Product Ruling applies the 'Rent' under the Lease Agreement and 'Management Fees' under the Management Agreement are only payable as a percentage of the proceeds from harvest and sale of the 'Trees', or from insurance proceeds. Interest payable under each of the Loan Agreements is

incurred and payable monthly. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement.

88. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project prepays interest under a loan agreement (including loan agreements with lenders other than FEA Ltd). 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.

89. As noted in the Ruling section above, 'Growers' who 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.

Deferral of losses from non-commercial business activities

Division 35

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

- 30 June 2006 to 30 June 2018; or
- the income year preceding the 'Harvest Year' (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; and
- 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.

Therefore, 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 for those income years.

91. 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

92. 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

93. 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).

94. The FEA Plantations 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 57 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.

95. 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 ‘Timber’. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm’s length or, if any parties are not dealing at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

96. 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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Commissioner of Taxation

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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

*Legislative references:**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
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- 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 1936 318
 - ITAA 1997 6-5
 - ITAA 1997 8-1
 - ITAA 1997 17-5
 - ITAA 1997 Div 27
 - ITAA 1997 Div 35
 - ITAA 1997 35-10
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 - ITAA 1997 35-55
 - ITAA 1997 35-55(1)(b)
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- ITAA 1997 328-105(1)(a)
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- Commissioner of Taxation v. Lau
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