



PR 2005/37 - Income tax: Macquarie Forestry Investment 2005 (Post 30 June 2005 Growers)

 This cover sheet is provided for information only. It does not form part of *PR 2005/37 - Income tax: Macquarie Forestry Investment 2005 (Post 30 June 2005 Growers)*

 This document has changed over time. This is a consolidated version of the ruling which was published on *23 March 2005*



Product Ruling

Income tax: Macquarie Forestry Investment 2005 (Post 30 June 2005 Growers)

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	71
Explanation	84
Example	129
Detailed contents list	130

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.

Preamble

*The number, subject heading, **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

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.

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 'Macquarie Forestry Investment 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;
- section 25-25 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Part 3-1 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 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.

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.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology and
the Arts
GPO Box 2154
Canberra ACT 2601

or by email to: commonwealth.copyright@dcita.gov.au

Date of effect

11. This Ruling applies prospectively from 23 March 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

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 dated 21 December 2004, and accepted as valid on 24 December 2004, as constituted by documents provided on 21 December 2004, 24 December 2004, 10 March 2005 and 15 March 2005 and additional correspondence dated 7 February 2005, 18 February 2005, 10 March 2005 and 15 March 2005;
- Draft Product Disclosure Statement of The Macquarie Forestry Investment 2005 received on 15 March 2005;
- Constitution of the Macquarie Eucalypt Project 2005 executed on 31 January 2005, as amended by the Amending Deed dated 16 February 2005;
- Draft second Amending Deed to the Constitution of the Macquarie Eucalypt Project, received 15 March 2005;

- Constitution of the Macquarie Eucalypt Project 2005 received with the Application for a Product Ruling dated 21 December 2004;
- Compliance Plan of the Macquarie Eucalypt Project 2005 dated December 2004;
- Draft Agreement for Ground Lease and Forest Property Agreement between Macquarie Bank Limited ('Landlord') and Macquarie Alternative Assets Management Limited ('Tenant') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Form of Lease between Macquarie Bank Limited ('Landlord') and Macquarie Alternative Assets Management Limited ('Tenant') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Form of Forest Property Agreement between Macquarie Bank Limited ('Grantor') and Macquarie Alternative Assets Management Limited ('Grantee') received with the Application for a Product Ruling dated 21 December 2004;
- Draft MFSPL Management Agreement between Macquarie Forestry Services Pty Limited ('MFSPL') and Macquarie Alternative Assets Services Management Limited ('MAAML') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Midway Management Agreement 2005 between Midway Pty Limited ('Midway'), Macquarie Forestry Services Pty Limited ('MFSPL'), Macquarie Alternative Assets Management Limited ('MAAML') and Macquarie Bank Limited ('MBL') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Midway Off-Take Agreement 2005 between Midway Pty Limited ('Midway') and Macquarie Alternative Assets Management Limited ('Manager') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Constitution of the Macquarie Timber Land Trust 2005 received with the Application for a Product Ruling dated 21 December 2004;
- Compliance Plan of the Macquarie Timber Land Trust dated December 2004;
- Draft Greening Australia Services Deed 2005 between Greening Australia Limited ('Service Provider'), Macquarie Forestry Services Pty Limited ('MFSPL'), Macquarie Alternative Asset Management Limited ('MAAML'), Macquarie Financial Products

Management Limited ('MFPML') and Macquarie Alternative Assets Management Limited ('Trustee') received with the Application for a Product Ruling dated 21 December 2004;

- Custody Agreement between Macquarie Alternative Assets Management Limited ('Manager') and Bond Street Custodians Limited ('Custodian') dated 26 March 2003;
- Amending Agreement in relation to the Custody Agreement dated 26 March 2003 between Macquarie Alternative Assets Management Limited ('Responsible Entity') and Bond Street Custodians Limited ('Custodian') dated 8 December 2003;
- Draft Notice of Addition in relation to the Custody Agreement dated 26 March 2003 in relation to the Macquarie Eucalypt Project 2005 between Bond Street Custodians Limited ('Custodian') and Macquarie Alternative Assets Management Limited ('Responsible Entity') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Custody Agreement in relation to the Macquarie Timber Land Trust 2005 between Macquarie Financial Products Management Limited ('Manager') and Bond Street Custodians Limited ('Custodian') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Agreement for Sale between Macquarie Bank Limited ('Owner') and Macquarie Financial Products Management Limited ('Transferee') received with the Application for a Product Ruling dated 21 December 2004;
- Draft Contracts of Sale between Macquarie Bank Limited ('Vendor') and Macquarie Financial Products Management Limited ('Purchaser') received with the Application for a Product Ruling dated 21 December 2004; and
- Draft Loan & Security Agreement between the Borrower and Macquarie Bank Ltd received with the Application for a Product Ruling received on 15 March 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. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

16. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

17. The salient features of the Macquarie Forestry Investment 2005 are as follows:

Location	The land will be located within an economic haulage distance of a log processor's mill gate in Victoria e.g. Midway's log processing facilities at the port of Geelong Victoria or log processing facilities located in the Morwell region of Eastern Victoria.
Type of business to be carried on by each participant in the Timber Product	Commercial growing and cultivation of varieties of eucalyptus trees including <i>Eucalyptus globulus</i> and <i>Eucalyptus nitens</i> for the purpose of harvesting and selling trees for woodchips and other timber products.
Number of hectares offered for cultivation	Approximately 5,000
Size of each interest	1 hectare
Minimum allocation	1 Interest for the Tree Project; 1 Unit for the Land Project.
Number of trees per hectare	Approximately 1,000
Term of the Project	Approximately 11.5 years
Initial cost	\$9,130 Plantation Establishment Fee for an Interest in the Timber Product and/or \$2,000 application fee for a Unit in the Land Product.
Ongoing costs	Deferred Management Fee of 5% of Net Sale Proceeds or any Tree Insurance Proceeds; Licence Fee of 10% of Net Sale Proceeds or any Tree Insurance Proceeds.
Other costs	Annual Tree Insurance premiums payable by the Growers; Productivity Performance Fee of 15% of Net Sale Proceeds in excess of \$13,500 per Interest.

18. The arrangement is called the Macquarie Forestry Investment 2005. The Project consists of the Macquarie Eucalypt Project 2005 ('the Timber Product') and the Macquarie Timber Land Trust 2005 ('the Land Product'). This Ruling only applies to participants in the Timber Product who take out insurance in respect of the trees, at or before the time of planting, against damage or destruction in terms of clause 5.1(b) of Schedule 1 of the Constitution of the Macquarie Eucalypt Project 2005. The Ruling does not address the tax consequences of disposing of Units in the Land Product.

19. Under the Product Disclosure Statement, Macquarie Alternative Assets Management Limited (**MAAML**) is offering Interests in the Timber Product at an application price of \$9,130 per Interest and Macquarie Financial Products Management Limited (MFPML) is offering Units in the Land Product at an application price of \$2,000 per Unit. The Timber Product and the Land Product are not stapled securities and investors may apply for Interests in the Timber Product ('**Growers**'), Units in the Land Product ('**Land Investors**') or both Interests in the Timber Product and Units in the Land Product ('**Growers**'). The minimum application for each Grower is one Interest in the Tree Product and/or one Unit in the Land Product.

20. MAAML will act as the Responsible Entity for the Timber Product and MFPML will act as the Responsible Entity for the Land Product. An Interest in the Timber Product is comprised of one Plantation Lot having a total area of one hectare which will be licensed by the Grower from the Timber Product Responsible Entity to carry on the business of growing eucalypt trees.

21. At the termination of the Project, on, or around, 31 December 2016, Midway Pty Limited ('Midway') will harvest and purchase the Grower's trees.

22. The Sale Period, being the period during which the Tree Product trees will be harvested or otherwise sold, is defined in the Product Disclosure Statement as running from 1 January 2016 to 31 December 2016. The Growers will receive their Net Sale Proceeds (which term is defined in paragraph 37) in instalments, which are expected to be on a monthly basis, throughout the Sale Period. The Sale Period will not be longer than 12 months. It is envisaged that upon purchase by Midway the timber will be harvested in accordance with the Midway Offtake Agreement.

23. Under the Midway Management Agreement, Midway is to select land in Victoria for the Project which satisfies a detailed protocol for land selection which has been developed by MBL. The protocol employs a site classification system based on climate and soils that correlates with plantation productivity predictions.

24. MBL will purchase suitable land recommended by Midway. Once it has acquired the land, MBL will, pursuant to the Agreement for Lease and Forestry Property Agreement, enter the Lease and Forest Property Agreement with MAAML for the term of the Project. MAAML will grant each Grower a Licence to access and conduct their afforestation business on their Plantation Lot. The Macquarie Timber Land Trust 2005 will then enter into an Agreement to acquire the land from MBL and the land will be transferred to the Macquarie Timber Land Trust 2005 subject to the Lease and the Forest Property Agreement. The Licence and Forestry Rights granted to the Grower under the Constitution will not be affected by the transfer of the land.

25. The land will be acquired and the Lease and Forest Property Agreement granted before the first of:

- (a) the expiry of 9 months after the grant of the Interest to the Investor; and
- (b) the date that is three months before the end of the Initial Term for that Interest.

MFPML, as the Macquarie Timber Land Trust 2005 Responsible Entity will hold the land on behalf of the Land Investors. The Macquarie Timber Land Trust 2005 will derive rental income and proceeds from the sale of the Project land at the termination of the Project. The Unit holders may receive distributions from the Macquarie Timber Land Trust 2005.

Constitution of the Macquarie Eucalypt Project 2005

26. The Constitution establishes the Scheme known as the Macquarie Eucalypt Project 2005 and operates as a deed declared to be for the benefit of and binding on the Members. It sets out the terms and conditions under which MAAML agrees to act as the Manager of the Scheme.

27. Under the Constitution the Manager must hold any Scheme Property on trust for Members or cause it to be held by a Custodian.

28. An applicant for Interests must complete the Application Form attached to the Product Disclosure Statement issued by the Manager in connection with the Scheme. Payment in a form acceptable to the Manager, of the part (if any) of the Plantation Establishment Fee which is not being provided by MBL as Lender for the applicant, must:

- (a) accompany the Member's Application; or
- (b) be received by or made available to the Manager or the Custodian within such period before or after the Manager receives the Member's Application as the Manager determines from time to time. This will be no later than one month after receipt of the Member's Application.

29. The balance (if any) of the Plantation Establishment Fee which is being provided by MBL as Lender for the applicant must also be received by the Manager before an Interest will be issued.

30. Money paid with or in relation to a Member's Application for an Interest is to be held by the Manager in a trust account in accordance with the Corporations Act pending the issue of the Interest. Once the Interest is issued the Manager may retain the Plantation Establishment Fee on its own account.

31. If the Manager rejects a Member's application, the Application Fee is to be refunded to the Member at the time that they are notified of the rejection.

32. MAAML grants each Grower a Licence to access and conduct their afforestation business on their Plantation Lot. MAAML also grants each Grower certain Forestry Rights in relation to their Plantation Lot, which include the vesting in the Grower of ownership of the Trees, Carbon Sequestration Rights and Environmental Credits (as defined in clause 25 of the Timber Product Constitution) in respect of the Grower's Plantation Lot.

33. The Constitution states the various fees and expenses to which the Manager is entitled during the term of the Project. Schedule 1 of the Constitution lists the Manager's obligations in respect of each Member during both the Initial Term and the period following the Initial Term, as follows:

- (i) the Manager shall purchase seedling trees selected from stock which it believes will produce yields in accordance with the assumptions outlined in the Product Disclosure Statement;
- (ii) the Manager will plant approximately the Required Number of trees (being 1,000) per hectare during the Initial Term for each Interest and will do all things necessary to ensure that the seedling trees are tended according to principles of good farming practice and sound agricultural methods; and
- (iii) the Manager will:
 - (a) not use the Land except for the purpose of the Member's Business and purposes ancillary to the Member's Business;
 - (b) control vermin and weeds to maintain satisfactory tree growth and to fulfil regulatory requirements with respect to noxious weeds and vermin;
 - (c) manage tree nutrition (monitoring and if reasonably required, treatment) to achieve or maintain satisfactory tree growth;

- (d) maintain firebreaks, access tracks and water supply points for fire suppression purposes and comply with all reasonable directions and all statutory requirements in relation to the prevention and control of fire;
- (e) liaise with the relevant government authorities with respect to fire suppression and prevention;
- (f) maintain a plantation inventory for the establishment of permanent growth plots and measurement at regular intervals (nominally at 1, 3, 5, 7 and 9 years of age);
- (g) monitor plantation health throughout the year;
- (h) liaise with the community and government in terms of dealings with neighbours, local government and regulatory authorities etc with respect to the ongoing management of the Land;
- (i) manage any grazing by livestock on the Land and the Other Land after 2 years following planting;
- (j) generally keep the Land and the Other Land (defined as the other land which the Manager requires access and use in order to perform its obligations) clean, tidy and in a condition suitable for the conduct of the Member's Business;
- (k) where reasonably required, maintain fencing for the protection of the Land and thereby the Trees of that Member;
- (l) not make any structural alterations or additions to the Land without the consent of Lessor;
- (m) not store nor use, nor permit to be stored or used, on the Land or Other Land any inflammable or dangerous substances, except as may be reasonably required for the ordinary conduct of the permitted use of the Land or the Other Land for the Member's Business and in accordance with regulatory requirements;
- (n) employ such staff and labour as are necessary for the purposes of performing its obligations including, without limitation, engaging the services of such consulting experts as may be necessary to assist the Manager in providing expert advice and assistance with respect to the growing of the Trees;

- (o) do all other things that are necessary or incidental to the carrying out of the Member's Business to produce a viable business of growing of the Trees for felling or sale when they are sufficiently mature;
- (p) if necessary, arrange for either or both harvesting and sale of the Timber;
- (q) report to the Member on an annual basis as to matters which the Manager determines the Member should be informed of;
- (r) perform its obligations under the Manager's Forestry Documents;
- (s) act as the Member's representative and exercise all of the Member's rights and perform all of the Member's obligations in respect of their Plantation Lot and the Trees; and
- (t) collect any other revenue derived from the Member's Plantation Lot.

34. In particular, the activities to be carried out by the Manager in the Initial Term for which the Plantation Establishment Fee is paid will be land cultivation, vermin control, site preparation (including clearing/earthworks), weed control, planting of seedlings and fertilisation associated with planting. These activities will not commence prior to the date of issue of an Interest.

35. The Initial Term for an Interest, which will be for a period of no more than 12 months, will vary depending on the date on which a Grower's Interest is allotted. The Initial Term will be:

- (a) for an Interest issued on or before 30 June 2005 – the period commencing on 30 June 2005 and ending on the first anniversary of that date; and
- (b) for an Interest issued on or after 1 July 2005 – the period commencing on the later of:
 - (i) the Allotment Date for that Interest (being the date of allotment of Interests to Members); and
 - (ii) 1 October 2005,

and ending on the first anniversary of that date.

36. The Manager will distribute or retain the Net Sale Proceeds and Other Income of each Member in the following order of priority:

- (a) retain an amount representing any liabilities incurred by the Manager in respect of that Member for the account of the Manager;
- (b) pay any provision for Environmental Debits to the Responsible Entity of the Macquarie Timber Land Trust 2005;

- (c) retain the Deferred Management Fee as set out in clause 18.2 of the Constitution for the account of the Manager;
- (d) distribute the Licence Fee in accordance with clause 7.1 of the schedule to the MAAML;
- (e) when the Net Sale Proceeds received by the Manager for the Member and all other Members in the Scheme exceed \$13,500 per Interest and the average yield of All Timber is greater than 240 GMT per Interest (or the average mean annual increment of All Timber is greater than 24.0), retain the Productivity Performance Fee; and
- (f) distribute the balance to the Member.

37. The Net Sale Proceeds in relation to a Member is defined as the Member's Proportional Interest of the proceeds of sale of All Timber of the Scheme less the cost of harvest, handling, loading, transport, processing, shipping and delivery costs which are received by the Manager.

38. A Member's Proportional Interest is the proportion which the aggregate Interests issued to that Member bears to all Interests issued to all the Members in the Scheme at that time. If a Plantation Lot is affected by an Event (being destruction or damage to any of the Trees) then the Member's Proportional Interest will be as determined by the Manager. In this situation the Manager will determine the proportion of that Member's Trees which remain, and the relative market value of those remaining Trees, as they relate to the Trees which would have been expected on the Plantation Lot licenced to that Investor.

39. If an Event occurs and Tree Insurance has been arranged by the Manager for a Member, the Manager will use the proceeds of the claim to replant the affected parts of that Member's Plantation Lot, if so directed by the Member before 30 June 2008. If the Manager is not so directed by the Member, the Manager must determine whether the proceeds are to be used to replant the affected parts of that Member's Plantation Lot or the proceeds shall accrue to the Manager on behalf of the Member.

40. The Scheme terminates on the earlier of:

- (a) the termination or expiration of every Lease and the last payment of the Net Sale Proceeds and Other Income; or
- (b) such later date in accordance with any extensions of time as determined by agreement by at least:
 - (i) a resolution or written agreement of Members with at least 75% of all Interests;
 - (ii) the unit holders who have at least 75 % of the Units in the Macquarie Timber Land Trust 2005; or

- (iii) Offtakers, to the extent that the Off-Take Agreements have not terminated and are affected by the determination.

Form of Lease

41. Under the Lease, MBL grants a lease to MAAML who takes a lease of the Land for the Term of the Project, on and subject to the terms of the Lease.

42. MBL also grants to the MAAML a licence to access and use the Other Land for all purposes having regard to the Permitted Use (as defined in clause 21 of the Lease) of the Land. This right is contractual, non-exclusive and irrevocable for the duration of the Term of the Project.

43. MAAML may:

- (a) sub-let any part of the Land for the Permitted Use of it sees fit without the consent of MBL;
- (b) grant non-exclusive licences or sublicences for the use of the Land and non-exclusive licences for the use of the Other Land for the Permitted Use as it sees fit; or
- (c) assign the Lease in accordance with the Scheme Constitution without the consent of MBL.

44. The Term of the Lease is the period commencing on the Commencement Date and expiring on the Termination Date. The Termination Date is the 30 June 2021, however MBL may terminate the Lease by notice to MAAML at any time in its absolute discretion after the later to occur of:

- (a) 31 December 2016; and
- (b) the final payment of the Net Sale Proceeds and the final payment of Other Income under the Scheme Constitution.

45. The Rent payable by the MAAML to MBL in relation to the Lease is the amount which is 10% of:

- (a) Net Sale Proceeds in arrears; or
- (b) where an Event occurs, that is, the trees are destroyed or damaged by fire, windstorm or hail, any Tree Insurance Proceeds (that are not applied in replanting the affected parts of the Land), when Tree Insurance Proceeds in respect of the Land are received by MAAML.

46. If a Grower's trees are destroyed or damaged and there is no replanting of the affected parts of the Grower's Plantation Lot, at MAAML's election, MAAML may surrender that part of the Plantation Lot over which those trees were planted, by notice to MBL.

Form of Forest Property Agreement

47. Under this Agreement, MBL, in consideration of MAAML paying the Rent under the Lease, vests ownership to MAAML of the Forest Property, Carbon Sequestration Rights and Environmental Credits in the Land for the Term of the Lease. MBL also acknowledges it has no interest in the Forest Property, Carbon Sequestration Rights and Environmental Credits for the Term of the Lease.

48. Clause 13.1 states that Forest Property Rights means the right to ownership of the Forest Property on the Land, the Carbon Sequestration Rights and any Environmental Credits.

Agreement for Ground Lease and Forest Property Agreement

49. MBL agrees to grant, or procure the grant, and MAAML agrees to accept the grant of the Lease and the Forest Property Agreement from and including the Commencement Date, being the settlement date under the relevant contract for the purchase of Project Land.

50. Under the Agreement, MAAML must deliver to MBL with this Agreement the Form of Lease and the Form of Forest Property Agreement in duplicate executed by MAAML to be held in escrow by MBL.

MFSPL Management Agreement 2005

51. Under this Agreement MAAML engages Macquarie Forestry Services Pty Limited (**MFSPL**) to undertake certain of its obligations under the Constitution for the Term of the Project. In particular, MFSPL will:

- (i) undertake all the activities listed at paragraph 33 with the exception of the activities listed at paragraph 33(iii)(p), (q), (r), (s) and (t);
- (ii) provide a grid identifying the Plantation Lot of all Growers;
- (iii) provide progress reports to MAAML detailing growth measurements;
- (iv) procure that annually or at such other intervals as are agreed an independent forestry advisor reviews the performance of its obligations under this agreement and the growth of the Trees and provides a copy of their report to MAAML;
- (v) enter into an agreement with Greening Australia Limited (or such other entities as MAAML requires) regarding, amongst other things, environmental services relating to the Scheme and comply with the terms of that Agreement; and

- (vi) where appropriate, advise MAAML on the availability of forestry techniques which may improve the returns to the Growers.

52. MAAML grants to MFSPL a licence to access and use (and to allow its subcontractors and agents to access and use) the Land and Other Land for all purposes necessary to carry out its obligations under this Agreement.

53. This Agreement commences on the Commencement Date and continues until the Termination Date. In terms of clause 12.4, the Termination Date is the same as that for the Scheme Constitution.

Midway Management Agreement 2005

54. Under this Agreement MFSPL sub-contracts some of its obligations under the MFSPL Management Agreement to Midway.

55. Midway and MFSPL agree that the former will provide the following services:

- (i) undertake all the activities listed at paragraph 33 with the exception of the activities listed at paragraph 33(iii)(p), (q), (r), (s) and (t);
- (ii) purchase seedling *Eucalyptus globulus* and *Eucalyptus nitens* trees selected from stock which it believes will produce yields in accordance with the assumptions outlined in the Disclosure Document;
- (iii) in relation to the planting of trees, Midway will plant approximately 1,000 trees per hectare during the Initial Term in a manner that results in a survival rate of at least 90% of the trees planted as measured 12 months from the time of planting and will do all things necessary to ensure that the seedling trees are tended according to principles of good farming practice and sound agricultural methods.

In the event that less than 90% of the trees planted survive for 12 months following the date of planting, undertake such additional planting of trees which would result in there being at least 900 trees per hectare;

- (iv) produce progress reports detailing growth measurements;
- (v) discuss where appropriate with MFSPL and Greening Australia Limited methods of complying with any agreement between MFSPL and Greening Australia Limited and others;

- (vi) prepare and deliver to MFSPL silvicultural working plans detailing the net plantable area and plantation establishment and maintenance strategy for all Land together with a grid identifying the Plantation Lot;
- (vii) undertake such site preparation work as is required to prepare the Plantation Lot for planting including:
 - (a) performing all reasonably required clean-up works; and
 - (b) completing all reasonably required cultivation works;
- (viii) undertake such vermin control work as is reasonably required to protect the Plantation Lot from damage (both before and after planting);
- (ix) undertake all reasonably required weed control work prior to and/or after planting to ensure that the Plantation Lot can be established and can achieve satisfactory growth;
- (x) undertake such fertilisation as is required at or about the time of the planting to promote establishment and satisfactory early growth;
- (xi) in the season following the planting of the seedling trees, undertake nutrition monitoring and fertilisation of, and weed control in, the Plantation Lot if reasonably required to promote or maintain satisfactory growth of the trees; and
- (xii) use its reasonable endeavours to identify on behalf of MBL land available for purchase which is suitable for the purposes of the Scheme, act in accordance with the Land Selection Protocol unless agreed otherwise with MBL, and generate a grid identifying the Plantation Lot.

Midway Off-Take Agreement 2005

56. Under the Midway Off-Take Agreement, Midway agrees to buy and the Manager agrees to sell the Timber at stump for the Selling Price. The Selling Price for All Timber at stump will be calculated and paid in accordance with the Pricing and Payment Schedule. This Schedule forms part of the Midway Off-Take Agreement and establishes the pricing and payment mechanisms for the Off-Take Agreement. Midway will pay to the Manager the Selling Price on behalf of each of the Growers.

57. Midway agrees with the Grower that it will, at its own cost and expense:

- (a) harvest the Timber by 31 December 2016 or such later date agreed in writing by Midway and the Manager but no later than 31 December 2021;
- (b) transport the Timber from the Land to Midway's Facility, Australian Paper's Maryvale Mill facility near Morwell, Victoria or to any other agreed place between Midway and the Manager prior to the end of the Sale Period (being the year in which all Standing Timber is to be harvested, currently expected to be 2016);
- (c) unless otherwise agreed, produce wood chips or other timber products from the Timber for sale to its Customers; and
- (d) unless otherwise agreed, market the wood chips to its Customers for sale.

58. MAAML grants to Midway a licence to access and use the Land and Other Land for all purposes necessary to carry out its obligations under this Agreement.

Custody Agreement

59. Under the Custody Agreement between MAAML and Bond Street Custodians Limited (as amended by the Amending Agreement and the draft Notice of Addition) MAAML appoints Bond Street Custodians Limited as the Custodian for the Timber Product and Bond Street Custodians Limited accepts the appointment as the Custodian of the Assets of the Timber Product on the terms and conditions of the Agreement.

60. Under the Custody Agreement between MFPML and Bond Street Custodians Limited, MFPML appoints Bond Street Custodians Limited as the Custodian for the Macquarie Timber Land Trust 2005 and Bond Street Custodians Limited accepts the appointment as the Custodian of the Assets of the Macquarie Timber Land Trust 2005 on the terms and conditions of the Agreement.

61. The Custody Agreements list both the duties and responsibilities of the Custodian in respect of the Assets of the Scheme and the general duties and responsibilities of the Custodian.

Constitution of the Macquarie Timber Land Trust 2005

62. The Constitution establishes the Trust known as the Macquarie Timber Land Trust 2005 and operates as a deed under which the Manager holds assets on trust for the Members. It sets out the terms and conditions under which MFPML agrees to act as the Manager of the Trust.

63. The beneficial interest in the Trust is divided into Units and each Unit confers an equal undivided interest. The Application Price for the Units is \$2,000 per Unit. Units will be issued to applicants where the Manager has accepted their application and received their application money.

Fees

64. The fees payable under the Constitution of the Macquarie Eucalypt Project 2005, on an Interest basis, are as follows:

- Plantation Establishment Fee of \$9,130 (inclusive of GST) payable on application for the maintenance and management of each Grower's Plantation Lot during the Initial Term;
- Deferred Management Fee for the maintenance and management of each Grower's Plantation Lot for the period commencing after the Initial Term and ending on the Termination Date being an amount equal to either 5% of the Net Sale Proceeds of each Grower or where an Event has occurred 5% of any Tree Insurance Proceeds;
- Productivity Performance Fee payable if the Net Sale Proceeds for a Grower exceed \$13,500 per Interest and the average yield of All Timber is greater than 240 GMT per Interest (or the average mean annual increment of All Timber is greater than 24.0). This Fee is payable for the maintenance and management of each Grower's Plantation Lot for the period commencing after the Initial Term and ending on the Termination Date;
- a Licence Fee is payable by the Growers for the Licence. The Licence Fee is an amount equal to 10% of either Net Sale Proceeds or where an Event occurs, any Tree Insurance Proceeds; and
- further, the handling fee for arranging Tree Insurance will be invoiced to the Growers as soon as practicable (but within thirty days). The invoiced amount will be payable by the Growers within thirty days of the invoice date.

65. The Application Fee payable under the Constitution of the Macquarie Timber Land Trust 2005 is \$2,000 per Unit.

Finance

66. Growers can fund their involvement in the Project themselves, borrow from MBL (a lender associated with the Responsible Entities) or borrow from an independent lender.

PR 2005/37

67. Where Growers borrow from MBL, all application monies received (both from Growers directly and from MBL) will be paid to the Managers to be held in separate trust accounts for the Timber Product and the Land Product in accordance with the *Corporations Act 2001*. Such application monies will be paid into the respective trust accounts on or before the issue date of the Interests or Units.

68. The finance made available by MBL is offered on the following terms contained in the Loan and Security Agreement:

Lender	MBL	MBL	MBL
Term¹	1 year	3 years	5 years
Indicative Interest Rate	No interest	9.05%	9.20%
Repayment Profile	1 year of equal monthly repayments ²	3 years of equal monthly repayments ²	5 years of equal monthly repayments ²
Interest Payments	Not Applicable	Monthly in arrears	Monthly in arrears
Application Fee	\$100 + 1% of Loan Amount	\$100	\$100

Lender	MBL	MBL
Term¹	10 years	10 years
Indicative Interest Rate	10.25%	10.25%
Repayment Profile	10 years of equal monthly repayments ²	Interest payments only for the first 3 years, followed by equal monthly repayments for the remaining 7 years
Interest Payments	Monthly in arrears	Monthly in arrears
Application Fee	\$100	\$100

¹ This assumes a Drawdown Date under the Investment Loan after 30 June 2005. If the Drawdown Date is on or before 30 June 2005, the Term of the Investment Loan will be longer, by an amount equal to the number of days from the Drawdown Date to 30 June 2005.

² Monthly payments of principal and interest will commence on the later of July 2005 and the month following the Drawdown Date.

In each case:

- maximum amount allowed to be borrowed is \$10,300 for every one Interest in the Timber Product and one Unit in the Land Product, except for the last option where the maximum amount to be borrowed is \$7,725 for every one Interest in the Timber Product and one Unit in the Land Product;
- the borrowing does not extend to GST. The GST payable in relation to the Plantation Establishment Fee (\$830) must be paid by the Borrower out of his/her own resources;
- the above repayments must be paid irrespective of the amount of any distribution from the Macquarie Eucalypt Project 2005 or the Macquarie Timber Land Trust 2005;
- the interest rate payable on the loan facility will be determined by MBL on the last business day of each month for loans approved the following month, and will be published on the Macquarie Forestry website. This indicative interest rate will be set on an arm's length commercial basis; and
- the Borrower is obliged to obtain and maintain Tree Insurance at all times during the term of any financial accommodation provided by MBL.

69. Growers cannot rely on this Product Ruling if a different finance arrangement is entered into with MBL or if application monies otherwise remain unpaid:

- on 1 October 2005, where the Grower's Interest is issued on or after 1 July 2005 and on or before 1 October 2005; and
- on the date the Grower's Interest is issued, where the Grower's Interest is issued after 1 October 2005.

70. 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 MBL, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

71. This Ruling applies only to Growers who are accepted to participate in the Project after 30 June 2005 provided that the Constitution of the Macquarie Eucalypt Project 2005 has been declared on or before the date of acceptance. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

72. 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

73. 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

74. 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

75. 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.

76. 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.

77. 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 Plantation Establishment Fees, Interest and Borrowing Costs

Section 8-1 and section 328-105

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

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

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Plantation Establishment Fee	\$9,130 See Notes (i) & (ii)		
Interest (MBL)	As incurred (Non-ST taxpayers) Or as paid (ST taxpayers) See Note (iii)	As incurred (Non-ST taxpayers) Or as paid (ST taxpayers) See Note (iii)	As incurred (Non-ST taxpayers) Or as paid (ST taxpayers) See Note (iii)
Borrowing costs for loans with MBL	Must be calculated – see Note (iv)	Must be calculated – see Note (iv)	Must be calculated – see Note (iv)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See Example 1 at paragraph 129.
- (ii) Under section 82KZMG the fee for establishment services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 109 to 115) 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) Interest is deductible under a loan agreement with MBL as described at paragraph 68. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than MBL, the internal financier, is outside the scope of this Ruling. However all Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 101 to 108 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.
- (iv) The Loan Application fee payable to MBL is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. However, where the total amount of a borrowing expense is \$100 or less, the full amount of the borrowing expense may be deducted in the year in which it is incurred and/or paid. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than MBL is outside the scope of this Ruling.

Units**Part 3-1**

80. The Units in the Macquarie Timber Land Trust 2005 are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

81. The amount paid for each Unit will represent the first element of the cost base of the Unit (subsection 110-25(2)). Any disposal of the Units by a Grower will be a CGT event and may give rise to a capital gain or loss.

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

Section 35-55 – exercise of Commissioner’s discretion

82. A Grower who is an individual accepted into the Project after 30 June 2005 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 2015**. 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

83. For a Grower who participates in the Project and incurs expenditure as required by the Macquarie Eucalypt Project 2005 Constitution, 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?

84. For the amounts set out in the Table above to constitute allowable deductions the Grower’s afforestation activities as a participant in the Macquarie Forestry Investment 2005 must amount to the carrying on of a business of primary production.

85. Where there is a business, or a future business, the gross proceeds from the sale of the wood produce 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.

86. For schemes such as that of the Macquarie Forestry Investment 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.

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

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

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

89. Under the Constitution the Manager is engaged by the Grower to establish and maintain a Plantation Lot 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 management services to establish and maintain the Plantation Lot on the Grower's behalf.

90. The Manager is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Plantation Lot.

91. 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.

92. 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 produce 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.

93. The pooling of wood produce from trees grown on the Grower's Plantation Lot with the wood produce of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled wood products will reflect the proportion of the trees contributed from their Plantation Lot.

94. 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 Plantation Lot is relatively small, it is of a size and scale to allow it to be commercially viable.

95. The Grower's degree of control over the Manager as evidenced by the Constitution, 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 Plantation Lot 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.

96. 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 Macquarie Forestry Investment 2005 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

97. 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.

98. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Plantation Establishment Fee***Section 8-1***

99. Consideration of whether the Plantation 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.

100. The Plantation 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 produce) 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 Plantation Establishment Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

101. 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.

102. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

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

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

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year;
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

105. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than MBL. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the resulting interest deduction is directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

106. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

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

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

108. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Section 82KZMG

109. Under subsection 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

110. Subsection 82KZMG(2) requires that the expenditure is:

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

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

- it must be an agreement for planting and tending trees for felling;
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (a right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and

- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

112. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling. The term 'seasonally dependent agronomic activities' is explained in Taxation Determination TD 2003/12.

113. Subsection 82KZMG(5) defines the 'establishment period to commence at the time that the first 'seasonally dependent agronomic activity' is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

114. Under the Constitution, a Grower incurs a Plantation Establishment Fee consisting of expenditure of \$9,130 for 'seasonally dependent agronomic activities'.

115. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2006 for the expenditure incurred under the Constitution for 'seasonally dependent agronomic activities'.

Interest deductibility

Section 8-1

(i) Growers who use MBL as the finance provider

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

117. 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 – the cultivation and growing of trees and the licence of the land on which the trees will have been planted – that will continue to be directly connected with the gaining of 'business income' and 'trust 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.

118. In the absence of any application of the prepayment provisions (see paragraphs 101 to 108); the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

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

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

121. 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 MBL 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.

122. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 101 to 108).

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

Section 35-55 – exercise of Commissioner's discretion

123. 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 2015** 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 ended 30 June 2006 up to and including 30 June 2015:

- 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.

124. 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

125. 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

126. 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).

127. The Macquarie Forestry Investment 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 79 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.

128. 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 produce. There are no facts that would suggest that Grower 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

129. 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

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	17
Constitution of the Macquarie Eucalypt Project 2005	26
Form of Lease	41
Form of Forestry Property Agreement	47
Agreement for Ground Lease and Forest Property Agreement	49
MFSPL Management Agreement 2005	51
Midway Management Agreement 2005	54
Midway Off-Take Agreement 2005	56
Custody Agreement	59
Constitution of the Macquarie Timber Land Trust 2005	62
Fees	64
Finance	66
Ruling	71
Application of this Ruling	71
The Simplified Tax System ('STS')	73
<i>Division 328</i>	73
Qualification	74
Assessable income	75
<i>Section 6-5 and section 328-105</i>	75
Deductions for Plantation Establishment Fees, Interest and Borrowing Costs	78
<i>Section 8-1 and section 328-105</i>	78

PR 2005/37

Units	80
<i>Part 3-1</i>	80
Division 35 – deferral of losses from non-commercial business activities	82
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	82
Sections 82KZME, 82KZMF and 82KL and Part IVA	83
Explanation	84
Is the Grower carrying on a business?	84
The Simplified Tax System	97
<i>Division 328</i>	97
Deductibility of Plantation Establishment Fee	99
<i>Section 8-1</i>	99
Prepayment provisions	101
<i>Sections 82KZL to 82KZMG</i>	101
<i>Sections 82KZME and 82KZMF</i>	103
<i>Section 82KZMG</i>	109
<i>Application of the prepayment provisions to this Project</i>	114
Interest deductibility	116
<i>Section 8-1</i>	116
<i>(i) Growers who use MBL as the finance provider</i>	116
<i>(ii) Growers who DO NOT use MBL as the finance provider</i>	121
Division 35 – deferral of losses from non-commercial business activities	123
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	123
Section 82KL – recouped expenditure	125
Part IVA – general tax avoidance provisions	126
Example	129
Entitlement to GST input tax credits	129
Detailed contents list	130

Previous draft:

Not previously issued as a draft

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;
TD 93/34; TD 2003/12

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Part 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 82KZME(1)

- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
- ITAA 1936 82KZMG(5)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
- 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 Pt 3-1
- ITAA 1997 108-5
- ITAA 1997 110-25(2)
- 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

ATO references:

NO: 2004/17739
ISSN: 1441-1172