



PR 2005/38 - Income tax: QPFL Project No. 9

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Product Ruling

Income tax: QPFL Project No. 9

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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 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

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 'QPFL Project No. 9' 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 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. Similarly, Growers who:

- elect to market their own timber; or
- meet the requirements set out in section 3 of the Product Disclosure Statement ('PDS') and negotiate a fee that differs from those set out in this Ruling;

are also excluded from the class of persons to whom this Ruling applies (see paragraphs 27 and 33).

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 30 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).

Note: The Addendum to this Ruling that issued on 25 January 2006, applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 11 November 2004 as constituted by documents provided on 15 November 2004, 18 November 2004, 9 February 2005, 23 February 2005, 14 March 2005 and 17 March 2005 and additional correspondence dated 8 February 2005, 23 February 2005, 14 March 2005 and 17 March 2005;
- Draft Product Disclosure Statement, undated, issued by QPFL, received in the Taxation Office on 17 March 2005;
- Draft Constitution of QPFL Project No. 9, ('the Constitution'), undated, received in the Taxation Office on 9 February 2005;
- Draft Compliance Plan for the QPFL Project No. 9, undated, received in the Taxation Office on 9 February 2005;
- Lease between Quality Land Holdings Pty Ltd ('Lessor') and QPFL ('Lessee'), signed on 5 April 2004;
- **Draft Farming Agreement between QPFL and the Grower**, undated, received in the Taxation Office on 14 March 2005;
- **Draft Plantation and Maintenance Agreement between QPFL and the Grower** ('the Plantation and Maintenance Agreement'), undated, received in the Taxation Office on 14 March 2005; and
- **Draft Loan Agreement** between QPFL Finance Pty Ltd and each **Grower**, undated, received in the Taxation Office on 15 November 2004.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

15. The documents highlighted are those that Growers may enter into. 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. The effect of these agreements is summarised as follows.

Overview

17. The salient features of the QPFL Project No. 9 are as follows:

Location	Forbes, NSW
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Paulownia fortunei</i> trees for the purpose of harvesting and selling timber.
Number of Woodlots on offer	3,000
Minimum number of Woodlots per application	1
Number of hectares available	996 hectares
Size of each Woodlot	0.332 hectares
Targeted Mean Annual Increment per Hectare	20-25m ³ over a rotation of 11 years.
Incentive fee	Responsible Entity will be entitled to ½ of the amount paid to the Grower over and above the 'Threshold Amount for the Incentive Fee for Timber Income' set out in the Product Disclosure Statement.
The term of the project	The date Harvest and Milling of all Trees has been completed.
Initial cost	\$5,500 per Woodlot
Initial cost per hectare	\$16,566
Ongoing costs	Annual Maintenance fees and licence fees. At the time of harvest and sale of the timber, harvesting, milling and marketing fees.

18. Under the Product Disclosure Statement, applicants are invited to participate in the QPFL Project No. 9. Growers entering into the Project will enter into the Farming Agreement that gives them a licence over an area of land called a 'Woodlot'. The Land Owner (Quality Land Holdings Pty Ltd) leases the land, at Forbes, NSW, to Queensland Paulownia Forests Limited (QPFL), the Responsible Entity, who grants a licence to the Grower. The licence allows the Responsible Entity, QPFL, to come onto the land to carry out its obligations under the Plantation and Maintenance Agreement. QPFL conducts its role as Responsible Entity and advisor under its Australian Financial Services Licence number 222305.

19. QPFL provides agricultural services to the Project under its role as Responsible Entity. The Grower will also enter into the Plantation and Maintenance Agreement with QPFL to have paulownia trees (*Paulownia fortunei*) planted on the Woodlot for the purpose of eventual felling and sale commencing when the Responsible Entity, in conjunction with the Project Forester, determines the Trees are suitable for Harvesting (clause 5.1(a)).

20. There are 3,000 Woodlots on offer of 0.332 hectares each at a cost of \$5,500 per Woodlot. The approximate stocking density will be 700 trees per hectare which will be planted within the first 12 months following execution of the Plantation and Maintenance Agreement.

Farming Agreement

21. Under the Farming Agreement, Growers are granted a licence by QPFL to use their Woodlot for the purpose of conducting their afforestation business (clause 2.1). The Grower must pay QPFL an initial licence fee of \$110 per Woodlot for the first twelve months (clause 6(a)(i)).

22. The term of the Agreement is either until harvesting and milling of all trees has been completed or termination of the Grower's Woodlot, whichever is the latest (clause 3.1(a)). The Grower must pay an annual licence fee of \$110 for the term of the Farming Agreement.

Plantation and Maintenance Agreement

23. The Plantation and Maintenance Agreement for each Woodlot is entered into by the Grower and QPFL. The term of the Agreement will continue until the Harvest and Milling of all Trees has been completed (cl. 3(a)) or the termination of the Grower's Interest.

24. The services to be provided by QPFL for an annual fee over the term of the Project are outlined in clause 4. An annual maintenance fee is to be paid for the term of the Plantation and Maintenance Agreement. QPFL will be responsible for planting *Paulownia fortunei* on the Woodlot and will then maintain the trees in accordance with good silvicultural practice until maturity.

25. The services to be provided by QPFL in clause 4.1 include duties to:

- a) acquire Trees for the Grower in the form of clonal tissue and seedlings for propagation, which Trees will be the property of the Grower for the duration of this Agreement;
- b) prepare the Land with adequate drainage for the Trees;
- c) establish, tend and maintain the Trees and Woodlot in a proper and skilful manner and as and when appropriate prepare, cultivate, spray herbicides and insecticides, and plant and fertilise Tree seedlings;
- d) comply with the laws and regulations relating to the use and occupancy of the Woodlot;
- e) embark on such operations as may be required to prevent or combat land degradation which may affect the yield of the Trees;
- f) keep accurate records of payments;
- g) carry out any obligations imposed on the Grower under the provisions of the Farming Agreement (except for the payment of fees by the Grower); and
- h) carry out any obligations of the Responsible Entity under the Constitution and Compliance Plan.

These services include both 'Seasonally Dependent Agronomic Activities' ('SDAA') and non-SDAA (refer to paragraphs 79 to 83). The Responsible Entity will complete all non-SDAA on or before 30 June 2005.

26. The Responsible Entity, QPFL, must perform the services under clause 4 within the first 12 months (clause 4.2), and must perform the services in clause 4.3 from the commencement of the 13th month of this Agreement onward and on an annual basis until this Agreement is at an end (clause 4.3). Initially seedlings propagated at Palm Range, Queensland may be used and a 'pole' nursery may be established at Forbes to provide stock for any replanting required. The seedlings will be 'acclimatised' or 'hardened off' prior to dispatch and before planting.

27. Prior to 30 June 2013, Growers may elect to collect the timber attributable to their Woodlots (Electing Growers) (clause 9.1), with at least three months written notice to the Responsible Entity, instead of having it milled and marketed on their behalf by QPFL. **This Ruling will not apply to Electing Growers.** If no such election is made, QPFL will sell the timber attributable to the Woodlots on the (Non-Electing) Grower's behalf, for the best possible commercial price (clause 6.2). QPFL will then be entitled to a marketing fee of 5.5% of the gross proceeds from the sale of the timber. Harvesting and milling of trees will take place when the Responsible Entity, in conjunction with the Project Forester, determines the Trees are suitable for Harvesting (clause 5.1(a)).

28. Growers who do not elect to collect their own timber will have the gross proceeds of sale of the timber attributable to their Woodlots paid to the Responsible Entity in its capacity as Custodian of the Project. The Responsible Entity will retain from the payment the Grower's proportional interest of the harvesting and milling costs, other costs of sale, and the Marketing and Incentive fee (clause 5 and clause 10.1). After payment of these expenses, the Responsible Entity will account to the Grower and pay the Grower their share of the net proceeds of sale. Each Grower's proportionate share of the sale proceeds of the pooled wood products will reflect the proportion of the trees contributed from their Woodlot (clause 7).

Constitution

29. The Constitution is between QPFL (in its capacity as the Responsible Entity) and the Growers. The Constitution sets out the terms and conditions under which QPFL agrees to act for the Grower and under which QPFL agrees to manage the Project. QPFL keeps a Grower register. Growers are only entitled to assign the Grower's Interest in certain circumstances (clause 18). Growers are bound by the Constitution by virtue of their participation in the Project.

Fees

30. The fees payable under clause 10 of the Plantation and Maintenance Agreement are:

- i) \$5,390 per Woodlot for the establishment services provided after the acceptance of the Application for a Woodlot made under the Product Disclosure Statement. The services to be provided are those in paragraph 25 as listed in 4.1(a) to (h) of the Plantation and Maintenance Agreement. These services include both 'Seasonally Dependent Agronomic Activities' ('SDAA') (\$4,568) and non-SDAA (\$822). The Responsible Entity will complete all non-SDAA on or before 30 June 2005;
- ii) Annual maintenance fees of \$275, reduced after each harvest, for the term of the Plantation and Maintenance Agreement;
- iii) An incentive fee calculated to be 55% of the amount paid to the Grower over and above the 'Gross Sale Proceeds from Timber' set out in the Product Disclosure Statement for the Project;
- iv) A marketing fee of not more than 5.5% of the gross proceeds generated from the sale of timber attributable to the Grower's Woodlot where QPFL sells on the Growers behalf; and
- v) All harvesting and milling costs.

31. The fee payable under clause 6 of the Farming Agreement is an initial licence fee of \$110 per Woodlot paid on application under the Product Disclosure Statement. An annual licence fee of \$110 for the term of the Farming Agreement.

32. The Responsible Entity will hold the application moneys in an application account to be released when certain specified criteria in the Constitution have been met (clause 15).

33. This Ruling does not apply to Growers who acquire Woodlots to the value of at least \$500,000, meeting the requirements set out in section 3 of the PDS, or who negotiate fees that are different to those in paragraphs 30 and 31.

Finance

34. Growers can fund their investment in the Project themselves, by borrowing from an associate of the Responsible Entity – QPFL Finance Pty Ltd or by borrowing from another independent lender.

35. Finance will be provided to Growers by QPFL Finance Pty Ltd under the following finance arrangements:

- Facility 1 – Interest free finance of twelve equal monthly principal instalments;
- Facility 2 – Payment of 10% deposit followed by monthly repayments of principle and interest over 5 years;
- Facility 3 – Payment of 10% deposit followed by monthly payments of interest only for first 2 years, then monthly repayments of principle and interest for 5 years; or
- Facility 4 – Payment of 10% deposit followed by monthly payments of interest only for first 3 years, then monthly repayments of principle and interest for 7 years.

36. Facility types 2 - 4 are subject to 11.25 % per annum interest rates based on current interest rates. A Grower must acquire a minimum of two Woodlots to be eligible for finance. The maximum amount of finance that can be received by any Grower is \$300,000. All payments will be monthly by direct debit on QPFL's Direct Debit System. Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears.

37. This Ruling will not apply to Growers if the Responsible Entity accepts their Application subject to finance approval by QPFL Finance Pty Ltd or any other lending institution and the full amount payable at the time of Application is not paid to the Responsible Entity by 30 June in the year of Application. Where an application is accepted subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 30 June.

38. The Application Price must be paid before or contemporaneously with the acceptance of the Application in accordance with the terms of clause 13 of the Constitution and such funds are to be paid into the Application Fund Account in accordance with the terms of clause 12 of the Constitution.

39. Growers cannot rely on this Ruling if a different finance arrangement is entered into with QPFL Finance Pty Ltd.

40. 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 QPFL Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

41. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 June 2005 and who have executed a Plantation and Maintenance Agreement and a Farming Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

42. 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***

43. 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 is different under the STS where the Grower uses the cash accounting method.

Qualification

44. 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.

Prepaid maintenance and licence fees***Sections 82KZME and 82KZMF***

45. The maintenance and licence fees incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Growers in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii) below).

46. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

In this Project, the tax deductions allowable for the maintenance fees and licence fees must be calculated by applying the above formula to the amount incurred by the Grower.

Assessable income

Section 6-5 and section 328-105

47. 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.

48. A Grower will recognise ordinary income from carrying on the business of afforestation at the time that income is derived when they are:

- not an 'STS taxpayer'; or
- an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years.

49. A Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is received.

Deductions for establishment services fees, maintenance fees, licence fees and interest

Section 8-1 and section 328-105

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

51. 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' using the cash accounting method 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 by the Grower who is an 'STS taxpayer' using the cash accounting method in the year in which it is incurred will be deductible in the year in which it is actually paid. The years shown in the Table below relate to a Grower who is accepted into the Project on or before 30 June 2005.

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Establishment services fee for Seasonally Dependent Agronomic	\$4,568 See Notes (i) & (ii)		

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Activities			
Establishment services fee for non-Seasonally Dependent Agronomic Activities	\$822 See Notes (i) & (ii)		
Maintenance fees		Must be calculated See Notes (i) & (iii)	Must be calculated See Notes (i) & (iii)
Licence fee	Must be calculated See Notes (i) & (iii)	Must be calculated See Notes (i) & (iii)	Must be calculated See Notes (i) & (iii)
Interest (QPFL Finance Pty Ltd)	As incurred (Non-STS taxpayers) or as paid (STS taxpayers) See Note (iv)	As incurred (Non-STS taxpayers and STS taxpayers using accruals accounting) or as paid (STS taxpayers) See Note (iv)	As incurred (Non-STS taxpayers and STS taxpayers using accruals accounting) or as paid (STS taxpayers) 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 105.
- (ii) The establishment services fee includes both 'Seasonally Dependent Agronomic Activities' ('SDAA' – see paragraphs 79 to 83) and non-SDAA. The Responsible Entity will complete all non-SDAA on or before 30 June 2005. The establishment services fee is deductible in the income year in which it is incurred (where the Grower is not an 'STS taxpayer' or is not an 'STS taxpayer' using the cash accounting method) or in the year in which it is paid (where the Grower is an 'STS taxpayer' using the cash accounting method).

- (iii) Although the Farming Agreement and the Plantation and Maintenance Agreement requires the licence fee and maintenance fee to be prepaid, for a Grower who acquires the minimum allocation, the amount of the prepaid licence fee and maintenance fee is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (where the Grower is not an 'STS taxpayer' or is not an 'STS taxpayer' using the cash accounting method) or in the year in which it is paid (where the Grower is an 'STS taxpayer' using the cash accounting method). However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid licence fee and maintenance fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for the prepaid licence fee and maintenance fee using the formula shown in paragraph 46.
- (iv) Interest is deductible under a loan agreement with QPFL Finance Pty Ltd as described at paragraphs 35 to 36. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than QPFL Finance Pty Ltd 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 72 to 78 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.

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

Section 35-55 – exercise of Commissioner's discretion

52. A Grower who is an individual accepted into the Project by 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 2005 to 30 June 2014**. 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

53. For a Grower who participates in the Project and incurs expenditure as required by the Plantation and Maintenance Agreement and the Farming Agreement 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?

54. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in the QPFL Project No. 9 must amount to the carrying on of a business of primary production.

55. 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.

56. For schemes such as that of the QPFL Project No. 9, 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.

57. 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 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 a afforestation business; and

- the weight and influence of general indicators point to the carrying on of a business.

58. In this Project, each Grower enters into a Plantation and Maintenance Agreement and a Farming Agreement.

59. Under the Farming Agreement each individual Grower will have rights over a specific and identifiable area of 0.332 hectares of land. The Farming Agreement 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 Responsible Entity to come onto to the land to carry out its obligations under the Plantation and Maintenance Agreement.

60. Under the Plantation and Maintenance Agreement the Responsible Entity 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 Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Woodlot on the Grower's behalf.

61. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the timber grown on the Grower's Woodlot.

62. 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.

63. 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.

64. The pooling of timber from the trees grown on the Grower's Woodlot with the timber of other Growers 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.

65. The Responsible Entity's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable.

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

67. 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 QPFL Project No. 9 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

68. 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.

69. 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 establishment service fee, maintenance fees and licence fees

Section 8-1

70. Consideration of whether the establishment services fee, maintenance fees and licence fees are 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.

71. The establishment services fee, maintenance fees and licence fees 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 timber) 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 fees appear to be reasonable. There is no capital component of the establishment fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMG

72. 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 licensing 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.

73. 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

74. 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)).

75. 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.

76. 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 QPFL Finance Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the resulting interest deductions are 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.

77. 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.

78. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula shown in paragraph 46, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

Section 82KZMG

79. 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).

80. 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.

81. 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.

82. 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.

83. 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

84. Under the Plantation and Maintenance Agreement, a Grower incurs a Year 1 establishment services fee consisting of expenditure of \$4,568 for 'seasonally dependent agronomic activities'.

85. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2005 for the expenditure incurred under the Plantation and Maintenance Agreement for 'seasonally dependent agronomic activities'.

86. The Plantation and Maintenance Agreement also requires that a Grower incurs a Maintenance Fee of \$275 per year, reduced after each harvest, during Years 2 to 11 for the performance of maintenance services during the term of the Project. Under the Farming Agreement a Grower incurs licence fees of \$110 to lease land during the term of the Project.

87. The expenditure incurred by a Grower in the Project for the maintenance fees and licence fees meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

88. The prepaid maintenance fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for a maintenance fee in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for a maintenance fee in the income year in which it is incurred.

89. However, where a Grower acquires more than three interests in the Project and the quantum of the prepaid maintenance fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

90. The prepaid licence fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for a licence fee in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for a licence fee in the income year in which it is incurred.

91. However, where a Grower acquires more than the minimum allocation in the Project and the quantum of the prepaid licence fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

Interest deductibility

Section 8-1

(i) Growers who use QPFL Finance Pty Ltd as the finance provider

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

93. The interest incurred for the year ended 30 June 2005 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – the cultivation and growing 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' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

94. As with the maintenance fees and the licence fees, in the absence of any application of the prepayment provisions (see paragraphs 72 to 78), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

96. 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 QPFL Finance Pty Ltd as the finance provider

97. 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 QPFL Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

98. 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 72 to 78).

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

Section 35-55 – exercise of Commissioner's discretion

99. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 to 30 June 2014** 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 2005 up to and including 30 June 2014:

- 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.

100. 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

101. 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

102. 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).

103. The QPFL Project No. 9 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 51 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.

104. 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**

105. 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 2004, 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:

PR 2005/38

Management fee for period 1/1/2005 to 30/6/2005	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2005 (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 2005, 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

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Commissioner of Taxation

30 March 2005

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Not previously issued as a draft

*Legislative references:**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

- 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 82KZME(1)
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- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
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- ITAA 1936 82KZMG(3)
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- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
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- ITAA 1997 6-5
- ITAA 1997 8-1

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- Corporations Act 2001

Case references:

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(1984) 16 ATR 55

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