



PR 2006/13 - Income tax: The Forestry Project 2006 and 2007 - 2007 Financial Year

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 March 2006*



Product Ruling

Income tax: The Forestry Project 2006 and 2007 – 2007 Financial Year

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ⓘ This Ruling provides you with the following level of protection:
 This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.
 A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.
 If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any under-paid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant taxation provision(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;
 - Subdivision 61-J 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 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 entities

7. The class of entities to which this Ruling applies is the entity more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme specified below on or after the date this Ruling is made. They will have a purpose of staying in the scheme 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 scheme. In this Ruling, these entities are referred to as 'Growers'. Specifically these 'Growers' will be either 'Group 2006 or 2007' class Growers, whose application is accepted up until 30 November 2006 and 30 June 2007, respectively.

8. The class of entities to whom this Ruling applies does not include entities who intend to terminate their involvement in the scheme 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 are also excluded from the class of entities to whom this Ruling applies (see paragraphs 31).

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 42.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 8 March 2006, 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).

13. 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 scheme 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

14. 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 entity within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

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

- Application for a Product Ruling received in the Tax Office on 20 December 2005 as constituted by documents provided on 16 January 2006 and 16 January 2006 plus additional correspondence dated 10 and 12 January 2006 and 10 and 14 February 2006;

- Draft Product Disclosure Statement received in the Tax Office on 16 January 2006;
- Draft Constitution of The Forestry Project 2006 and 2007 ('the Constitution') received in the Tax Office on 16 January 2006;
- Draft Compliance Plan for The Forestry Project 2006 and 2007 received in the Tax office on 16 January 2006;
- **Farming Agreement between QPFL and the Grower received in the Tax Office on 16 January 2006;**
- **Plantation and Maintenance Agreement between QPFL and the Grower** ('the Plantation and Maintenance Agreement') received in the Tax Office on 16 January 2006;
- **Loan Agreement** between QPFL Finance Pty Ltd and each **Grower** received in the Tax Office on 16 January 2006; and
- **Loan Agreement** between United Pacific Finance Pty Ltd and each Grower received in the Tax Office on 13 February 2006.

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

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the scheme 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 scheme. The effect of these agreements is summarised as follows.

17. 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

18. The salient features of 'The Forestry Project 2006 and 2007' are as follows:

Location	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
Size of each Woodlot	See note below
Targeted Mean Annual Increment per Hectare	18-23m ³ over a rotation of 12 years
Trees planted per hectare	700 approximately
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	12 years
Initial cost	\$5,500 per Woodlot
Ongoing costs	Annual Maintenance fees and licence fees. At the time of harvest and sale of the timber, harvesting, milling and marketing fees.

Note:

Unit sizes will range from 0.405 to 0.289 hectares depending on prevailing site productivity of the properties as follows:

Required Size	Productivity Rates of the Land (over the life of the project)
0.405 hectares	200 cubic metres / hectare
0.332 hectares	244 cubic metres / hectare (used in calculating the Incentive Fee)
0.289 hectares	280 cubic metres / hectares

19. Under the Product Disclosure Statement, applicants are invited to participate in The Forestry Project 2006 and 2007. 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 leases the land, 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.

20. 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)).

21. There are 3,000 Woodlots on offer 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.

Constitution

22. 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 19). Growers are bound by the Constitution by virtue of their participation in the Project.

Compliance Plan

23. The Compliance Plan for the Forestry Project 2006 and 2007 describes how the Responsible Entity will ensure it complies with the *Corporations Act 2001* and the Project's Constitution.

24. The Responsible Entity will act as Custodian and hold all Project Property. Project Property excludes the separate and distinct primary production business owned and operated by the Grower and the Trees whilst they remain on the Grower's Allotment. As a prudential compliance measure the Responsible Entity has therefore appointed a custodial committee to carry out certain supervisory and other duties.

Interest in Land – Farming Agreement

25. 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)).

26. 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 (clause 6(c)).

Plantation and Maintenance Agreement

27. 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 (clause 3(a)) or the termination of the Grower's Interest.

28. 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.

29. 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 83 to 87). The Responsible Entity will complete all non-SDAA on or before 30 June 2007.

30. 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.

31. Prior to the first harvest period, 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)).

32. 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).

Fees

33. 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 29 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 2006;
- ii. annual maintenance fees of \$275 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 'Net 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.

34. 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 is payable for the term of the Farming Agreement.

35. 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 16).

Finance

36. 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 United Pacific Finance Pty Ltd or another independent lender.

37. Finance will be provided to Growers by QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd under the following finance arrangements:

- Facility 1 – payment of the application price excluding GST interest free finance of twelve equal monthly principal instalments commencing on 20th of the month following;
- Facility 2 – payment of the application price excluding GST by monthly instalments of principal and interest over 5 years commencing on the 20th of the month following;
- Facility 3 – payment of the application price excluding GST by monthly instalments of principal and interest for 7 years commencing on the 20th of the month following; or
- Facility 4 – payment of the application price excluding GST by monthly instalments of principal and interest for 9 years commencing on the 20th of the month following.

GST will be invoiced on acceptance of the application and payable 21 days after invoice.

38. 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 for loans granted by QPFL Finance Pty Ltd will be made 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.

39. This Ruling will not apply to Growers if the Responsible Entity accepts their Application subject to finance approval by QPFL Finance Pty Ltd or United Pacific 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 2007. 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 2007.

40. The Application Price must be paid before or contemporaneously with the acceptance of the Application in accordance with the terms of clause 14 of the Constitution and such funds are to be paid into the Application Fund Account in accordance with the terms of clause 13 of the Constitution.

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

42. 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 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

43. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Plantation and Maintenance Agreement and a Farming Agreement after 30 June 2006 and on or before 30 June 2007. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

44. 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

45. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method' – see section 328-120 of the *Income Tax (Transitional Provisions) Act 1997*).

46. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that the amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that the amount is included in assessable income when received.

Qualification

47. 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.

25% entrepreneurs tax offset

Subdivision 61-J

48. For the first income year starting on or after 1 July 2005, subdivision 61-J of the ITAA 1997 provides for a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Prepaid maintenance and licence fees

Sections 82KZME and 82KZMF

49. The maintenance and licence fees incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME of the ITAA 1936 and 82KZMF of the ITAA 1936. In this context, a prepayment refers to advance expenditure incurred by a Grower 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)).

50. Subsection 82KZMF(1) of the ITAA 1936 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 activity under the agreement is to be done. The eligible service period begins on the day on which the activity 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 activity under the agreement ceases to be done, up to a maximum of 10 years.

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

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

51. 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 of the ITAA 1997), will be assessable income of the Grower under section 6-5 of the ITAA 1997.

52. The Grower recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

Deductions for management fees, maintenance fees, licence fees and interest

Sections 8-1 and 328-105

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

54. However, if for any reason, an amount shown or referred to in the Tables 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(s) 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 2007	Year ended 30 June 2008
Establishment services fee for seasonally dependent agronomic activities	\$4,568 See Notes (i) & (ii)	
Establishment services fee for non seasonally dependent agronomic activities	\$822 See Notes (i) & (ii)	
Maintenance fees		Must be calculated See Notes (i) & (iii)
Licence fee	Must be calculated See Notes (i) & (iii)	Must be calculated See Notes (i) & (iii)
Interest (QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd)	As incurred See Note (iv)	As incurred 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 of the ITAA 1997.
- (ii) The establishment services fee includes both 'Seasonally Dependent Agronomic Activities' (SDAA – see paragraphs 83 to 87) and non-SDAA. The Responsible Entity will complete all non-SDAA on or before 30 June in the year in which the fee is incurred.
- (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. 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 50.

- (iv) Interest is deductible under a loan agreement with QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd as described at paragraph 36. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd, 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 75 to 82 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

55. A Grower who is an individual accepted into the Project after 30 June 2006 and on or before 30 June 2007 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10 of the ITAA 1997. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55 (1)(b) of the ITAA 1997 for these Growers for the income years ending **30 June 2007 to 30 June 2019**. 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

56. 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:

- section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA of the ITAA 1936 will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

Is the Grower carrying on a business?

57. For the amounts set out in the Tables above to constitute allowable deductions the Grower's afforestation activities as a participant in The Forestry Project 2006 and 2007 must amount to the carrying on of a business of primary production.

58. 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.

59. For schemes such as that of The Forestry Project 2006 and 2007, 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.

60. 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.

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

62. Under the Farming Agreement each individual Grower will have rights over a specific and identifiable area of between 0.289 to 0.405 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 Project Manager to come onto to the land to carry out its obligations under the Management Agreement.

63. Under the Management 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 Project Manager 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.

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

65. 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.

66. 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.

67. The pooling of wood produce from trees grown on the Grower's Woodlot 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 Woodlot.

68. 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.

69. 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.

70. 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 Forestry Project 2006 and 2007 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

71. Subdivision 328-F of the ITAA 1997 sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G of the ITAA 1997 sets out the rules for entering and leaving the STS.

72. Changes to the STS rules apply from 1 July 2005. 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 services fee, maintenance fees and licence fees

Section 8-1

73. Consideration of whether the establishment services fees, maintenance fees and licence fees are deductible under section 8-1 of the ITAA 1997 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.

74. 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 wood produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1 of the ITAA 1997. Further, no 'non-income producing' purpose in incurring the fees is identifiable from the scheme. The fees appear to be reasonable. There is no capital component of the establishment services 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

75. 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.

76. For this Project, only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936 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

77. Other than expenditure deductible under section 82KZMG of the ITAA 1936, if the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (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)).

78. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the agreement (or scheme) 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 scheme are managed by someone other than the taxpayer; and
- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the entity who promotes, arranges or manages the agreement (or an associate of that entity) promotes similar agreements for other taxpayers.

79. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4) of the ITAA 1936). 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 or United Pacific Finance Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the scheme. The funds borrowed and the resulting interest deduction are directly related to the activities under the scheme. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

80. 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) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the scheme that is less than \$1,000. Such expenditure is immediately deductible.

81. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 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.

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

82. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) 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

83. Under section 82KZMG(1) of the ITAA 1936, 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) of the ITAA 1936.

84. Subsection 82KZMG(2) of the ITAA 1936 requires that the expenditure is

- incurred on or after 2 October 2001 and on or before 30 June 2008;
- 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.

85. To satisfy subsection 82KZMG(3) of the ITAA 1936 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.

86. Under subsection 82KZMG(4) of the ITAA 1936 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.

87. Subsection 82KZMG(5) of the ITAA 1936 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

88. Under the Plantation and Maintenance Agreement, a Grower incurs a Year 1 Management Fee consisting of expenditure of \$4,568 for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG of the ITAA 1936 have been met, a deduction is allowable in the income year ended 30 June 2007 for the expenditure incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

89. The Management Agreement also requires that a Grower incurs a Maintenance Fee of \$275 per year during Years 2 to 12 for the performance of maintenance services during the term of the Project. Under the Farming Agreement a Grower incurs licence fees of \$110 to licence land during the term of the Project.

90. 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) of the ITAA 1936 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 of the ITAA 1936.

91. The prepaid maintenance fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1) of the ITAA 1936. Under Exception 3 (subsection 82KZME(7) of the ITAA 1936) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF of the ITAA 1936. A Grower can, therefore, claim an immediate deduction for a maintenance fee in the income year in which it is incurred.

92. 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) of the ITAA 1936.

93. The prepaid licence fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1) of the ITAA 1936. Under Exception 3 (subsection 82KZME(7) of the ITAA 1936) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF of the ITAA 1936. A Grower can, therefore, claim an immediate deduction for a licence fee in the income year in which it is incurred.

94. 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) of the ITAA 1936.

Interest deductibility

Section 8-1

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

95. Some Growers may finance their participation in the Project through a loan facility with QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 of the ITAA 1997 depends on the same reasoning as that applied to the deductibility of lease and management fees.

96. The interest incurred for the year ended 30 June 2007 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 of the ITAA 1997.

97. As with the management fees and the lease fees, in the absence of any application of the prepayment provisions (see paragraphs 75 to 82), interest is deductible in the year in which it is incurred.

(ii) Growers who DO NOT use QPFL Finance Pty Ltd or United Pacific Finance Pty Ltd as the finance provider

98. 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 or United Pacific Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with schemes where all details and documentation have been provided to, and examined by the Tax Office.

99. 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 75 to 82).

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

Section 35-55 – exercise of Commissioner's discretion

100. In deciding to exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 on a conditional basis for the income years **30 June 2007 to 30 June 2019** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 of the ITAA 1997 – non commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2007 up to and including 30 June 2019:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35 of the ITAA 1997; and
- there is an objective expectation that within a period that is commercially viable for the Paulownia industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 of the ITAA 1997 or produce a taxation profit.

101. Therefore, a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) of the ITAA 1997 until a later income year is able to offset that loss against their other assessable income.

102. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) of the ITAA 1997 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 of the ITAA 1997 to those changed circumstances.

Section 82KL – recouped expenditure

103. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1997.

Part IVA – general tax avoidance provisions

104. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C of the ITAA 1936) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D of the ITAA 1936).

105. The Forestry Project 2006 and 2007 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 54 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.

106. 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 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) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 93/34; TD 2003/12;
TR 92/20; TR 97/11; TR 98/22;
TR 2000/8; TR 2001/14

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 - gronomic activity
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
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- ITAA 1936 82KZME(1)
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- ITAA 1997 Div 35
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Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR55

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