



PR 2006/151 - Income tax: Kiri Park Projects: 2007 Growers - 1 July 2007 to 30 September 2007 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 November 2006*



Product Ruling

Income tax: Kiri Park Projects: 2007 Growers – 1 July 2007 to 30 September 2007 Growers

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) 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 underpaid 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 provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling, the scheme is referred to as the 'Kiri Park Projects: 2007 Growers' or simply as 'the Project'.

Relevant provision(s)

2. The relevant provision(s) dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- section 25-25 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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. Entities 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 entities in schemes such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that entities are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling (refer to paragraphs 56 to 58 of this Ruling) and who enter into the scheme specified below during the period 1 July 2007 to 30 September 2007 and execute a Lease and Management Agreement on or before 30 September 2007. 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. In this Ruling, these entities are referred to as 'Growers'.

8. The class of entities to whom this Ruling applies does not include entities who:

- are accepted to participate in the Project prior to 1 July 2007 or after 30 September 2007;
- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- elect to market and sell the timber grown on their Woodlot(s);
- have their application conditionally accepted by Environmental Forest Farms Management Limited subject to finance for the payment of the Application Price, where the finance has not been approved by the lender by 30 September 2007 or the finance has been approved and the funds have not been made available to Environmental Forest Farms Management Limited by 30 September 2007; or

- enter into finance arrangements with entities associated with Environmental Forest Farms Management Limited, other than the arrangements with Forestry Finance Ltd, described at paragraphs 49 to 54 of this Ruling.

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 17 to 55 of this Ruling.

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 1 November 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

13. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

14. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

15. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provisions ruled upon, to all entities 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

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

- Application for a Product Ruling received 31 July 2006 as constituted by the following documents and additional correspondence including emails received on 18 August 2006, 12 September 2006, 18 September 2006, 4 October 2006, 5 October 2006, 6 October 2006, 11 October 2006 and 12 October 2006;
- Draft Product Disclosure Statement ('PDS') for the 'Kiri Park Projects: 2007 Growers' issued by Environmental Forest Farms Management Limited (the 'Responsible Entity'), received 31 July 2006;
- Draft **Lease and Management Agreement** between Environmental Forest Farms Management Limited (as Responsible Entity) and Powton Land Holdings Limited (the 'Lessor') and the Grower, received 31 July 2006;
- Draft **Constitution** for the Kiri Park Projects, received 31 July 2006;

- Draft Constitution Deed of Variation for the Kiri Park Projects, received 11 October 2006;
- Draft Compliance Plan for the Kiri Parks Projects, received 31 July 2006;
- Draft Independent Foresters report for the Kiri Park Projects, received 18 August 2006; and
- Finance Packages including **Loan Agreements**, received 12 October 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

18. The documents highlighted (in bold) are those that Growers may enter into. 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 that are part of the scheme to which this Ruling applies.

19. 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

20. The main features of the 'Kiri Park Projects: 2007 Growers' are as follows:

Location	Regan's Ford, Shire of Gingin, Western Australia
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Paulownia fortune</i> (Paulownia) trees for the purpose of harvesting and selling timber
Number of hectares offered for cultivation	88.128
Minimum application	1 Woodlot
Size of each Woodlot	0.108
Number of Trees per Woodlot	60
Number of trees per hectare	Approximately 555 trees
Term of the Project	Approximately 10 years
Initial cost	\$6,390 per Woodlot (this includes an amount for prepaid fees)
Ongoing and other costs	Annual Rent and Management Fees Annual Insurance Harvesting and Processing Fee Incentive Fee Harvest Marketing Fee

21. The Project will be registered as a Managed Investment Scheme under the *Corporations Act 2001*. Environmental Forest Farms Management Limited has been issued with Financial Services Number 239635 and will be the Responsible Entity for the Project.
22. The Project involves the cultivation of Paulownia trees and the harvest and sale of the timber from the trees.
23. The Project will be conducted on land known as 'Kiri Park', at Lot M1254, Hunter Road, Regan's Ford, in the shire of Gingin, Western Australia (approximately 150 kilometres north of Perth). The land for the Project is owned by Powton Land Holdings Limited (the 'Lessor'). Powton Land Holdings Limited is in the process of identifying further suitable land for Paulownia plantations, which may be secured in the event of oversubscription, subject to the approval of a Forestry Expert.
24. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). This offer pertains to 816 Woodlots of 0.108 hectares each. The term of the project is 10 years. There is no minimum subscription for the Project. A Grower that participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of one Woodlot.
25. The Woodlots will be planted at the rate of approximately 555 trees per hectares. Water for the Project is available from developed bores and a large dam on the property. The Lessor will provide or arrange to provide the irrigation system in accordance with silvicultural standards suitable for paulownia plantations.
26. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to enter into, on behalf of the Grower, a Lease and Management Agreement and any other agreements required to hold an interest in the Project.
27. For the purposes of this Ruling, applicants who are accepted to participate in the Project and who execute a Lease and Management Agreement during the period from 1 July 2007 to 30 September 2007 will become '1 July 2007 to 30 September 2007 Growers'. Note that Product Ruling PR 2006/150 may apply to Growers who are accepted into project during the period from 1 November 2006 to 30 June 2007.

Constitution

28. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Environmental Forest Farms Management Limited agrees to act as the Responsible Entity and manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. The Responsible Entity will maintain a register of all Growers that are accepted to participate in the Project (clause 26).

29. Under the terms of the Constitution, all monies received from Applications will be paid into an Application Fund and the proceeds of the sale of forest produce will be paid into a Proceeds Fund.

30. Once the Responsible Entity is satisfied of the matters specified in clause 14, the Application Moneys will be released to the Responsible Entity and applied towards payment of the fees payable under the Lease and Management Agreement.

Compliance Plan

31. The Responsible Entity has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity meets its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease and Management Agreement

32. Growers participating in the scheme will enter into a Lease and Management Agreement with Powton Land Holdings Limited as the Lessor, and Environmental Forest Farms Management Limited as the Responsible Entity. Growers are granted an interest in the land in the form of a Lease for a period of 10 years to use their Woodlot for the purposes of conducting their afforestation business until the final distribution of sale proceeds is made to the Grower or until the Project is terminated. Growers are specifically granted rights to harvest timber on their Woodlot for this purpose. The Lease is granted upon the terms and conditions outlined in the Lease and Management Agreement.

33. Under the Lease and Management Agreement each Grower appoints the Responsible Entity to perform the Services and the Responsible Entity accepts the appointment. The Responsible Entity will supervise and manage all silvicultural activity on behalf of the Grower in accordance with good silvicultural practice. Item 8 of the Schedule to the Lease and Management Agreement specifies the Initial Services and On-going Services to be performed by the Responsible Entity.

34. The Initial Services include:

- ploughing, ripping and other soil preparation works for each Woodlot;
- procurement of seedlings;
- tending to seedlings prior to planting;
- planting the Paulownia seedlings on the Leased Area at a rate equivalent to 60 trees per Woodlot by 31 December 2007;
- applying fertilisers, herbicides and pesticides; and

- reduction and eradication of disease, vermin and other pests.

35. The On-Going Services include:

- cultivating, tending, pruning, fertilising, replanting, spraying and otherwise caring for the Trees as and when required;
- maintaining and keeping in good repair access laneways within the Leased Area;
- maintaining the Leased Area according to good silvicultural and forestry practices;
- replacing any Trees that fail to establish or that die during the first twelve months of the Project;
- harvesting Trees grown on the Leased Area in Years 7, 8, 9 and 10 and processing the timber in accordance with clause 17 of the Lease and Management Agreement; and
- carrying out any other obligation to be performed by the Responsible Entity pursuant to the terms of any agreement entered into by the Responsible Entity for the sale of the Forest Produce.

36. The Responsible Entity will maintain a public risk insurance policy in respect of the Plantation and arrange for insurance of the Leased Area, including the Trees and Forest Produce, on behalf of all Growers (clause 21 of the Lease and Management Agreement). This insurance is compulsory and the annual insurance premium will be divided proportionally over all Woodlot interests in the Project.

37. In the event that the Trees on the Grower's Woodlot(s) are destroyed (either fully or partially), the Grower's Proportional Share in the Project and in the sale proceeds will be reduced in accordance with clause 21 of the Lease and Management Agreement.

38. The Responsible Entity must provide to each Grower a report on or before 31 October of each year providing details of services provided and the status of the Trees on the Woodlot(s) (clause 15 of the Lease and Management Agreement).

Harvesting and sale

39. The Grower is entitled to the Trees and the timber produced on their Woodlots. Growers may elect, on Application, to sell their timber produce by giving written notice to the Responsible Entity. This Ruling does not apply to Growers who make such an election. The Responsible Entity will sell the timber harvested on behalf of the Growers who do not make such an election (defined for the purposes of this Ruling as 'Non-Electing Growers') for the highest price practicable.

40. Commercial thinning of trees is expected to occur from Years 7 to 9. In Year 10 the remaining trees will be harvested and processed. The Responsible Entity will Harvest and Process, or engage a suitably qualified person to Harvest and Process the percentage of trees as set out in the PDS, unless the Responsible Entity believes that it would be in the best interests of the Growers to defer the Harvest to a later date.

41. The Responsible Entity is appointed to market and sell the Forest Produce from each Non-Electing Grower's Woodlot(s) on such terms and conditions as the Responsible Entity considers appropriate. The Responsible Entity may pool the Forest Produce from the harvest.

42. The Responsible Entity is to ensure that the Gross Sale Proceeds are deposited into the Proceeds Fund (clause 20 of the Lease and Management Agreement). From the Proceeds Fund the Responsible Entity will pay:

- the Grower's proportional share of Harvesting and Processing Costs;
- the Incentive Fee (if any);
- any Annual Contribution then due and payable by the relevant Grower;
- any other amounts owed to the Responsible Entity or the Lessor by the relevant Grower; and
- 5.5% of the Gross Sale Proceeds for Harvest Marketing Costs.

43. The remaining balance is to be paid to the Grower in accordance with each Grower's Proportional Share.

Fees

44. The Application Price payable to the Responsible Entity on application is \$6,390 per Woodlot. This amount is represented by:

- Fee for Land Preparation and Planting of Trees of \$5,680;
- Management Fee of \$627 for services to be provided from the Commencement Date to 30 June 2008; and
- Rent of \$83 for the period from the Commencement Date to 30 June 2008.

45. The Annual Contribution payable in subsequent income years is as follows:

- Management Fee of \$627 payable in advance on or before 30 June for the following income year, for the 2009 income year onwards. The Management Fee for the 2011 income year onwards will be the amount payable for the previous income year increased at the rate of the Consumer Price Index;

- Rent of \$83 payable in advance on or before 30 June for the following income year for the 2009 income year onwards. The Rent for the 2011 income year onwards will be the amount payable for the previous income year increased at the rate of the Consumer Price Index; and
- Insurance of the Leased Area (including the Trees and Forest Produce), will be arranged by the Responsible Entity. The insurance premium will be divided proportionally over all Woodlot interests in the Project.

46. From 1 July 2008 onwards, the Responsible Entity may obtain the approval of a Forestry Expert to increase the Annual Contribution if the Responsible Entity estimates that the total actual cost of providing Tree Farming, including corporate overhead costs, insurance premiums and indexation is likely to exceed the amounts set out in the Schedule to the Lease and Management Agreement (clause 23.3 of the Lease and Management Agreement).

47. The Responsible Entity is also entitled to the following amounts that will be deducted from the Gross Sale Proceeds:

- The Grower's Proportional Share of Harvesting and Processing Costs;
- an amount equal to 5.5% of the Gross Sale Proceeds for Harvest Marketing Costs as per clause 17.3 of the Lease and Management Agreement; and
- an Incentive Fee equal to 27.5% of the amount by which the Net Harvest Return exceeds the Incentive Fee threshold estimated in the PDS.

Finance

48. Growers can fund their involvement in the Project themselves, borrow from Forestry Finance Limited (a lender associated with the Responsible Entity) or borrow from an independent lender.

49. A Grower choosing to pay the Application Price of \$6,390 per Woodlot by entering into a finance arrangement with Forestry Finance Ltd must complete the Finance Application Form in the relevant Finance Package. All arrangements will be on a full recourse commercial basis and recovery action will be taken in respect of any default.

50. Growers who enter into a Loan Agreement with Forestry Finance Ltd are required to pay a deposit of at least 10% of the Application Price (\$639 per Woodlot) and an Application Fee of \$300 on application.

51. The balance after the 10% deposit is repayable under the following payment options:

- 5 years principal and interest – 60 monthly payments of \$129.39;
- 8 years principal and interest – 96 monthly payments of \$95.06; and
- 12 month interest free – 12 monthly repayments of \$479.25.

52. Except for the interest free option, the interest rate is fixed at 12% per annum for loans less than \$5,000 or 12.5% per annum for loans greater than \$5,000 (up to a maximum of \$50,000). The interest payable from the date of Application to 30 September 2007 is included in the Principal Sum. Repayments of principal and interest (or principal only in the case of the 12 month interest free option) are made monthly in advance commencing on 1 October 2007.

53. As security over the loan, the Grower agrees for a fixed charge to be placed over the Grower's interest in the Project, including the Lease and Management Agreement, the timber growing on the Woodlot(s) and all cut Timber products and proceeds of sale.

54. Forestry Finance Ltd will only provide loans to Growers where it has sufficient funds to do so.

55. 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 Forestry Finance Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

56. This Ruling applies only to Growers who:

- are accepted to participate in the Project during the period from 1 July 2007 to 30 September 2007;
- have executed a Lease and Management Agreement on or before 30 September 2007;
- have paid the Application Price by 30 September 2007; and
- have not elected to market and sell the timber grown on their Woodlot(s).

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

58. 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

59. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where a Grower who was an 'STS taxpayer' prior to the 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

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

25% entrepreneurs tax offset

Subdivision 61-J

61. For the first income year starting on or after 1 July 2005, Subdivision 61-J 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.

Assessable income**Section 6-5**

62. 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.

63. A Grower will be assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is derived.

Deductions for the Land Preparation and Tree Planting fee, Management Fees, Rent, Interest and Borrowing Costs**Section 8-1 and section 25-25**

64. A Grower acquiring one Woodlot may claim tax deductions for the fees and expenses listed in the Table below:

Fee Type	ITAA 1997 Section	2008 Income Year	2009 Income Year	2010 Income Year
Land Preparation and Tree Planting fee	8-1	\$5,680 See Notes (i) & (ii)		
Management Fees	8-1	\$627 See Notes (i) and (ii)	\$627 See Notes (i), (iii) and (v)	\$627 See Notes (i), (iii) and (v)
Rent	8-1	\$83 See Notes (i) and (ii)	\$83 See Notes (i), (iii) and (v)	\$83 See Notes (i), (iii) and (v)
Interest (for finance obtained from Forestry Finance Ltd)	8-1	See Notes (iv) and (v)	See Notes (iv) and (v)	See Notes (iv) and (v)
Borrowing Expenses	25-25	See Note (vi)	See Note (vi)	See Note (vi)

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: Division 27.
- (ii) The Land Preparation and Tree Planting fee, Management Fee and Rent payable on application are deductible in the income year in which they are incurred.

- (iii) The Lease and Management Agreement requires the Management Fees and the Rent for the 2009 income year onwards to be prepaid. A Grower who acquires the minimum allocation of one Woodlot, will incur prepaid Management Fees of \$627 and prepaid Rent of \$83. These amounts will be deductible in full under section 8-1 in the year they are incurred as they are 'excluded expenditure' being less than \$1,000. Refer to paragraphs 88 to 95 of this Ruling for a discussion of the prepayment provisions.

Where a Grower acquires more than the minimum allocation in the Project, the amount of either or both of these prepaid fees may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the relevant deduction for the prepaid Management Fee and prepaid Rent according to the formula in subsection 82KZMF(1) of the ITAA 1936 (see paragraph 94 of this Ruling).

- (iv) Interest payable to Forestry Finance Ltd under the finance arrangements described at paragraph 51 of this Ruling is deductible in the income year in which it is incurred. The deductibility or otherwise of interest incurred under any other finance arrangements (including finance arrangements with a bank or financier other than Forestry Finance Ltd) is outside the scope of this Ruling.
- (v) This Ruling does not apply to Growers who choose to prepay fees or rent (except as described in 64(iii) of this Ruling) or who choose to or are required to prepay interest under a loan agreement. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (vi) The Application Fee relating to the finance arrangements is a borrowing cost and is deductible under section 25-25. It is incurred for borrowing funds that are to be used during the income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility of borrowing expenses arising from finance arrangements other than the finance arrangements described at paragraph 51 of this Ruling with Forestry Finance Ltd outside the scope of this Ruling.

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

Section 35-55 – exercise of Commissioner’s discretion

65. A Grower who is an individual accepted into the Project during the period from 1 July 2007 to on or before 30 September 2007 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 2008 to 30 June 2013**. 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 82KL and Part IVA

66. For a Grower who participates in the Project and incurs expenditure as required by the Lease and Management Agreement the following provisions of the ITAA 1936 have application as indicated:

- 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.

Commissioner of Taxation

1 November 2006

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?

67. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the 'Kiri Park Projects: 2007 Growers' must amount to the carrying on of a business of primary production.

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

69. For schemes such as that of the 'Kiri Park Projects: 2007 Growers', 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 TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Grower has an identifiable interest (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 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 an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

71. In this Project, each Grower enters into a Lease and Management Agreement.

72. Under the Lease and Management Agreement each individual Grower will have rights over a specific and identifiable area of 0.108 hectares of land. The Lease provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The lease allows the Responsible Entity to come onto the land to carry out its obligations under the Lease and Management Agreement.

73. Under the Lease and 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 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.

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

75. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

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

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

78. 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.

79. The Grower's degree of control over the Responsible Entity as evidenced by the Lease and Management 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.

80. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' afforestation activities in the 'Kiri Park Projects: 2007 Growers' will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

82. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. 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 Land Preparation and Tree Planting Fee, Management Fees and Rent

Section 8-1

83. Consideration of whether the Land Preparation and Tree Planting Fee, Management Fees and Rent 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.

84. The Land Preparation and Tree Planting Fee, the Management Fees and Rent 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 produce) is to be gained from this business.

They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fees is identifiable from the scheme. The fees appear to be reasonable. There is no capital component of the fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Deductibility of interest

Section 8-1

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

85. Some Growers may finance their participation in the Project through a loan facility with Forestry Finance Ltd as described at paragraph 51 of this Ruling. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Land Preparation and Tree Planting fee, Management Fees and Rent.

86. The interest incurred for the year ended 30 June 2008 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of trees and the lease 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.

(ii) Growers who enter into other finance arrangements

87. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance arrangement other than the finance arrangements described at paragraph 51 of this Ruling 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.

Prepayment provisions

Sections 82KZL to 82KZMF

88. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example, the performance of forestry services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

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

90. 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)).

91. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the 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:
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the entity who promotes, arranges or manages the agreement (or an associate of that entity) promotes similar agreements for other taxpayers.

92. For the purpose of these provisions, the scheme includes all activities that relate to the scheme (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 Forestry Finance Ltd. Although undertaken with an unrelated party, that financing would be an element of the scheme. The funds borrowed and the resulting interest deductions 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.

93. 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. 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.

94. 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.

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

95. 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.

Application of the prepayment provisions to this Project

Management Fees and Rent

96. The expenditure incurred by a Grower in the Project for the Management Fees and Rent for the 2009 income year onwards, 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.

97. For a Grower who acquires the minimum of one Woodlot, the prepaid Management Fee and the prepaid Rent, being amounts each 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. Therefore a Grower who acquires one Woodlot may claim deductions for the Management Fee and Rent in the income year in which the expenses are incurred.

98. Growers who acquire more than one Woodlot may incur prepaid Management Fees or Rent exceeding \$1,000. Those Growers will need to calculate the deduction for each year using the formula in subsection 82KZMF(1) of the ITAA 1936. Section 82KZMF will apportion the deduction for prepaid fees over the eligible service period which commences on 1 July of the year following the year of payment and ends on 30 June of that year.

99. Therefore, any prepaid Management Fee or Rent exceeding \$1,000 incurred in an income year, will be deductible in the following income year.

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) on a conditional basis for the income years **30 June 2008 to 30 June 2013** 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 2008 up to and including 30 June 2013:

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

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) 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) 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

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), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

105. The 'Kiri Park Projects: 2007 Growers' 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 in paragraph 64 of this Ruling 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:

TR 97/11; TR 98/22; TR 2000/8;
TR 2001/14; TD 2003/12

Subject references:

- advance deductions and expenses for certain forestry expenditure
- borrowing expenses
- 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
- chemes
- 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
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- ITAA 1936 82KZME
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- ITAA 1936 82KZME(2)
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- ITAA 1997 Div 35
- ITAA 1997 35-10
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NO: 2006/12878
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ timber