

PR 2006/165 - Income tax: ITC Diversified Forestry Project Stage 1 (2007)

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *20 December 2006*



Product Ruling

Income tax: ITC Diversified Forestry Project Stage 1 (2007)

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! 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. 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.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Product Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the 'ITC Diversified Forestry Project Stage 1' or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Grower.

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 26 of this Ruling on or before 30 June 2007. They must 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.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling 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;
- are accepted into this Project before the date of this Ruling or after 30 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- enter into finance arrangements with entities associated with this project, other than those specified in paragraphs 55 to 59 of this Ruling;
- have not paid the Establishment Services Fee by 30 June 2007, where they have not entered into a finance arrangement; or

- have their application conditionally accepted by a lending institution subject to finance for the payment of the Establishment Services Fee, where the finance has not been approved by the lender by 30 June 2007 or the finance has been approved but the funds have not been made available to ITC Projects Management Limited ('ITCPM') by 31 July 2007.

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 26 to 64 of this Ruling.

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

- this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

8. This Product Ruling applies prospectively from 20 December 2006, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 20 December 2006 until 30 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2009.

9. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or

- the relevant provisions are not amended.

10. 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)).

11. 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.

12. 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).

Changes in the Law

13. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. Entities who are considering participating in the scheme 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

15. 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 participants are fully informed of any legislative changes after the Product Ruling is issued.

Goods and Services Tax

16. All fees and expenditure referred to in this Product 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.

Ruling

Application of this Ruling

17. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 26 to 64 of this Ruling.

18. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Management Agreement and Land Agreement or Agreement to enter into Land Agreement.

The Simplified Tax System (STS)

Division 328

19. 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 depending on whether the Grower was an 'STS taxpayer' prior to 1 July 2005 and 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*.

20. For these Growers only, 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

21. 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 and section 17-5**

22. 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.

Deductions for Establishment Services Fees and Interest**Section 8-1, section 25-25, Division 27, section 40-880, and section 82KZMG of the Income Tax Assessment Act 1936**

23. A Grower may claim tax deductions for the revenue expenses listed in the Table below on a 'per Diversified Forestry Unit' basis:

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Establishment Services Fee	\$5,500 See Notes (i) & (ii)		
Interest	As incurred See Note (iii)	As incurred See Note (iii)	As incurred See Note (iii)
Borrowing costs (finance offered by ITC Finance Pty Ltd or by the Nominated Financier)	Must be calculated See Note (iv)	Must be calculated See Note (iv)	Must be calculated See Note (iv)
Administration Fee (12 Month Terms Arrangement)	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated See Note (v)

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) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the fee for Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 83 to 85 of this Ruling) and is deductible in the income year in which it is incurred.

- (iii) Interest under a loan agreement with ITC Finance Pty Ltd or the Nominated Financier as described at paragraph 58 to 64 of this Ruling is deductible. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd or the Nominated Financier is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with ITC Finance Pty Ltd and the Nominated Financier, should read the discussion of the prepayment rules in paragraphs 78 to 82 of this Ruling as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.
- (iv) The Loan Application Fee of \$250 plus 0.4% of the loan amount is a borrowing cost and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd or the Nominated Financier is outside the scope of this Ruling.
- (v) The Administration Fee payable to ITCPM for the Terms Arrangement is not deductible in full when it is incurred. Under section 40-880 it is deductible on a straight line basis over five income years (see paragraphs 76 to 77 of this Ruling).

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

Section 35-55 – exercise of Commissioner's discretion

24. A Grower who is an individual accepted into the Project in the year ended 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. 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 Growers for the income years ended **30 June 2007 to 30 June 2027**. 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.

Prepayment provisions and anti-avoidance provisions

Sections 82KZME, 82KZMF and 82KL and Part IVA

25. For a Grower who commences participation in the Project and incurs expenditure as required by the Land Agreement and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

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

- Application for a Product Ruling as constituted by documents dated 21 August 2006 and additional correspondence, including emails, dated 28 August 2006, 29 September 2006, 23 November 2006 and 30 November 2006;
- Draft **Product Disclosure Statement** for ITC Diversified Forestry Project Stage 1, received 23 November 2006;
- Draft ITC Diversified Forestry Project Stage 1 **Scheme Constitution**, received 21 August 2006;
- Draft Compliance Plan for ITC Project Management Limited, received 21 August 2006;
- Draft **Land Agreement** between ITC Project Management Ltd ('Lessor') and the Grower, received 21 August 2006;
- Draft **Memorandum (Land Agreement Provisions)** for the ITC Diversified Forestry Project Stage 1, received 21 August 2006;
- **Agreement to enter into Land Agreement**, received 21 August 2006;
- **Management Agreement** between ITC Project Management Limited and the Grower, received 21 August 2006;

- Draft **Memorandum (Management Agreement Provisions)** for the ITC Diversified Forestry Project Stage 1, received 21 August 2006;
- Draft **Tree Farm Loan Agreement** between the Nominated Financier, ITC Finance Pty Ltd and/or their nominees ('the Lender') and 'the Borrower', received 21 August 2006;
- Draft Tree Farm Loan Deed between ITC Finance Pty Ltd and the Nominated Financier, received 21 August 2006;
- Draft Forestry Management Agreement between Integrated Tree Cropping Ltd ('ITC') and ITC Project Management Ltd, relating to the ITC Diversified Forestry Project Stage 1, received 21 August 2006;
- Draft Service Agreement between Australian Plantation Timber Limited and Integrated Tree Cropping Limited, received 21 August 2006;
- Draft Management Plan for the ITC Diversified Forestry Project Stage 1, Tree Farm(s), received 21 August 2006;
- Draft Independent Experts Forester's Report for the ITC Diversified Forestry Project Stage 1 Product Disclosure Statement (PDS), dated 5 April 2006 and received 21 August 2006; and
- Memorandum of Association ITC Project Management Limited, received 21 August 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.

27. The documents in bold are those that a Grower 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.

28. 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.

29. The main features of ITC Diversified Forestry Project Stage 1 are as follows:

Locations	Esperance Region on the Western Australian south coast (Pulpwood); Kununurra region in the north of Western Australia (Teak & Sandalwood); Coastal regions of far north Queensland (Teak & Red Mahogany); Bundaberg/Gladstone or Mackay regions of central Queensland (Pulpwood); Green Triangle region of western Victoria and south-eastern South Australia (Pulpwood); and Albany and/or Bunbury regions of Western Australia (Pulpwood).
Type of business to be carried on by each participant	Commercial growing and cultivation of trees for the purpose of harvesting and selling timber.
Number of hectares offered for cultivation	Approximately 10,000 hectares
Size of each interest	Approximately 1 hectare
Minimum allocation	2 Diversified Forestry Units
Term of the Project	20 years
Initial cost	\$11,000
Ongoing costs	Annual Insurance premiums
Deferred costs	Management Fees – 34.1% of Project Proceeds; and Land Fees – 11.55% of Project Proceeds.
Other costs	Cost of Harvest and Marketing – Payable from Project Proceeds Compulsory post Harvest Commencement Insurance – Payable from Project Proceeds

30. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is ITC Project Management Ltd. Under the ITC Diversified Forestry Project Stage 1 Product Disclosure Statement, ITCPM proposes to offer interests called 'Diversified Forestry Units'. There is no minimum subscription for the Project.

31. The land will be assessed by ITCPM as being suitable for the establishment of commercial plantations in accordance with a methodology endorsed by the Independent Forester.

32. Under this offer, a Grower may enter the Project during the period from the date of this Ruling to 30 June 2007. Growers entering the Project during the period from the date of this Ruling to 30 June 2007 may be covered by this Product Ruling.

33. Growers participating in the scheme will enter into a Land Agreement with ITCPM. The Land Agreement is executed over an identifiable area of land called a 'Diversified Forestry Unit'. Each Diversified Forestry Unit will comprise an area of approximately 1 hectare containing:

- approximately 0.75 hectares of Pulpwood being Tasmanian Blue gum (*Eucalyptus globulus*), Rose gum (*E. grandis*) and hybrids of River red gum (*E. grandis* × *E. camaldulensis*), Spotted gum (*Corymbia citriodora* subsp. *variegata* and *C. maculata*) or Dunn's White gum (*E. dunnii*);
- approximately 0.1 hectare of Large Fruited Red Mahogany (*E. pellita*);
- approximately 0.1 hectare of Teak (*Tectona grandis*); and
- approximately 0.05 hectare of Indian Sandalwood (*Santalum album*);

to be located at the various properties utilised by the project.

34. Growers will also enter into a Management Agreement with ITCPM for the management of their Diversified Forestry Units. ITCPM will be responsible for establishing, cultivating and harvesting the trees. The trees are expected to be harvested approximately 7 – 20 years after planting, depending on the species. ITCPM will arrange for the sale of the timber.

35. To participate in the Project, Growers must pay an Establishment Services Fee. The balance of the fees, including a Management Services Fee and Land Fee will be deducted from any amounts payable to the Grower from the Project Proceeds.

36. Upon application, Growers will execute a Power of Attorney enabling ITCPM to act on their behalf as required. This will enable ITCPM to enter into Project agreements on behalf of the Growers.

Constitution

37. 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 ITCPM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

38. Under the terms of the Constitution, all moneys received from applications will be paid to the Responsible Entity, which shall deposit those moneys into a trust account, held by the Responsible Entity (clause 5.1). The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 9.1).

39. The proceeds from the sale of timber will be paid direct to the Responsible Entity who must deposit them into a Proceeds Fund (clause 30). Each Grower will have a share in the Proceeds Fund, which will be distributed amongst them according to their Proportional Interest (clause 31). The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1.1.

Compliance Plan

40. ITCPM has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Interest in Land

Land Agreement

41. Upon application, ITCPM will enter into an Agreement to enter into a Land Agreement with the Grower. This agreement will only be entered into if ITCPM can procure suitable land and provide the Establishment Services within 12 months of the Grower incurring the fees for those services. If the land is procured ITCPM will execute a Land Agreement on behalf of the Grower.

42. Under the Land Agreement Growers acquire an interest in land called a Diversified Forestry Unit. Each Diversified Forestry Unit will comprise approximately 1 hectare. Growers will have a right to use their Diversified Forestry Units from the date of execution of the Land Agreement to the termination date for the purpose of conducting their afforestation business.

43. The Land Agreement incorporates the provisions of the Memorandum (Land Agreement Provisions). Some of the conditions of the Memorandum are that the Grower will:

- not use the Diversified Forestry Units for a purpose other than growing and harvesting trees (clause 4(a));

- comply with sound silvicultural and environment practices adopted within the forestry industry (clause 4(b)); and
- comply with all laws and regulations relating to the use and occupancy of the Grower's Diversified Forestry Units (clause 4(c)).

Agreement to enter into Land Agreement

44. Where there is no Project land available for a Grower on or before 30 June 2007, the Grower will be required to enter into an Agreement to enter into Land Agreement with ITCPM.

45. Pursuant to the terms of the Agreement to enter into Land Agreement the parties undertake to enter into a Land Agreement within 9 months from date of acceptance into the Project, which will allow all the Establishment Services referred to in the Management Agreement to be completed within 12 months after the date the Establishment Services Fee is incurred by the Grower.

Management Agreement

46. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the Agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultants and other specialist services as may be reasonably necessary. The provisions of the Memorandum (Management Agreement Provisions) are incorporated in the Management Agreement.

47. The services which ITCPM must perform are specified in Schedule 2 of the Memorandum. The services include the following:

Item 1 – Establishment Services

- procure sufficient trees, to the specifications recommended in the Management Plan;
- prepare the land for planting, in accordance with the Management Plan;
- plant trees; and
- supervise and secure management of the works described above.

Item 2 – Management Services

- manage the tree crop in accordance with the Management Plan and good silvicultural practices;
- maintain adequate stocking of the plantation by replacing any contiguous area of dead or missing trees in accordance with the Management Plan;

- prune the Tree Crop as and when required in accordance with the Management Plan;
- use reasonable endeavours to arrange the sale of the Tree Crop, and enter into a sale agreement or sale agreements as agent for the Grower pursuant to which the proceeds of sale will be paid to ITCPM;
- prepare a Harvesting plan for the Tree Crop and manage the Thinning and the Clearfall Harvest;
- select and engage contractors to carry out the Harvest;
- manage the Harvesting in accordance with the Harvesting Plan; and
- effect insurance after the Clearfall Harvest Commencement Date, as required in accordance with this Agreement.

48. ITCPM will complete the delivery of all Establishment Services within 12 months of the date the Establishment Services Fee is incurred by the Grower, or within 12 months after the Grower pays the fee, whichever is the earlier (clause 3.2(a) of the Management Agreement Memorandum).

49. The Management Services will commence from 1 July 2007 or the date of the execution of the Management Agreement, whichever is later (clause 3.2(b) of the Management Agreement Memorandum).

Pooling of Timber and Grower's Entitlement to Net Proceeds

50. The Management Agreement sets out provisions relating to the Grower's Entitlement to Harvest Proceeds. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed wood produce are entitled to benefit from distributions of Harvest Proceeds from the pool; and
- any pooled wood produce must consist only of wood produce contributed by Growers of the same Project Class.

Fees

51. The following amounts are payable to ITCPM for each Diversified Forestry Unit:

- **Establishment Services Fee** of \$5,500 payable on or before the date of execution of the Management Agreement. (Item 1 of Schedule 3 of the Management Agreement Memorandum);

- **Management Services Fee** equal to 34.1% of the Project Proceeds, (defined in clause 1 of the Management Agreement Memorandum) deducted from these proceeds. (Item 2 of Schedule 3 of the Management Agreement);
- **Land Fee** equal to 11.55% of the Harvest Proceeds, deductible from these proceeds. (Schedule 2 to the Land Agreement Memorandum);
- **Costs of Harvest and Marketing** equal to the Grower's proportion of the Harvesting and Marketing costs, which may be deducted from the Proceeds Fund (clause 9 of the Management Agreement Memorandum). This fee is for 'Costs of Harvest and Marketing' as defined in clause 1.1 of the Management Agreement Memorandum; and
- **Insurance Premiums** to insure the Grower's tree crop, from completion of the Establishment Services, against loss or damage caused by fire and/or any other insurable risk. Annual premiums will be paid by ITCPM and invoiced to the Grower (clause 10.2 of the Management Agreement Provisions Memorandum). Also to insure the Grower's tree crop, from the harvest commencement date (the 30th June immediately before the commencement of the Clearfall Harvest), against loss or damage caused by fire and/or any other insurable risk. These premiums will be paid by ITCPM and deducted from the Project Proceeds (clause 10.2 of the Management Agreement Provisions Memorandum and clause 32 of the Constitution).

Finance

52. A Grower who does not pay the Establishment Services Fee in full upon application can borrow from, or execute a Terms Agreement with ITC Finance Pty Ltd, borrow from the Nominated Financier, or borrow from an independent lender external to the Project.

53. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with ITC Finance Pty Ltd or with the Nominated Financier that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than the Nominated Financier may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

54. Other than where a Terms Agreement is in place, Growers cannot rely on any part of this Ruling if the Establishment Services Fee is not paid in full on or before 30 June 2007 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted subject to finance approval by any lending institution other than ITC Finance Pty Ltd, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2007.

Finance offered by ITC Finance Pty Ltd

55. Growers can fund their Establishment Services Fee as follows:

- from their own financial resources;
- through a Terms Payment agreement with the Responsible Entity;
- through finance offered by ITC Finance Pty Ltd (a lender associated with the Responsible Entity);
- through finance available through a Nominated Financier; or
- by borrowing from an independent lender.

56. The Terms Payment agreement offered to Growers by the Responsible Entity will be provided on the following terms:

- Administration Fee of \$275;
- Interest free; and
- Balance payable by 11 equal monthly instalments.

57. Where ITCPM accepts an application from a Grower to pay the Establishment Services Fee under a Terms Agreement the full amount of the Establishment Services Fee must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

58. The finance provided by ITC Finance Pty Ltd and the Nominated Financier will be offered under the 'Tree Farm Loan' finance package. The minimum loan amount is \$15,000. The terms and conditions are as follows:

3 year reducing balance

- Minimum deposit of 10%;
- Application Fee of \$250 plus 0.4% of the loan value, capitalised in the total borrowings;
- 36 monthly instalments of principal and interest; and
- interest rates will be fixed for the period of the loan and are set on a commercial basis.

5 year reducing balance

- Minimum deposit of 10%;
- Application Fee of \$250 plus 0.4% of the loan value, capitalised in the total borrowings;
- 60 monthly instalments of principal and interest; and
- interest rates will be fixed for the period of the loan and are set on a commercial basis.

10 year reducing balance

- Minimum deposit of 10%;
- Application Fee of \$250 plus 0.4% of the loan value, capitalised in the total borrowings;
- 120 monthly instalments of principal and interest; and
- interest rates will be fixed for the period of the loan and are set on a commercial basis.

59. The Nominated Financier will also provide the following Finance package:

10 year reducing balance (3 year interest only and 7 year principal and interest

- Minimum deposit of 10%;
- Application Fee of \$250 plus 0.4% of the loan value, capitalised in the total borrowings;
- 36 monthly instalments of interest then 84 monthly instalments of principal and interest; and
- interest rates will be fixed for the period of the loan and are set on a commercial basis.

60. The interest rate is fixed for the term of the loan or for the term of the loan after the Interest-Only Loan Period (as defined in clause 20 of the Tree Farm Loan Deed). The interest rate will be the same for finance provided by either ITC Finance Pty Ltd or the Nominated Financier.

61. The deposit and the amount borrowed from ITC Finance Pty Ltd and the Nominated Financier will be paid into the Application Fund that is maintained by the Responsible Entity (clause 5 of the Constitution and clause 1(b) of the Tree Farm Loan Deed).

62. The financiers will offer the finance on a full recourse basis. Security will be a fixed charge over the borrower's interest in the Project. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

63. This Ruling will not apply to Growers who enter into finance arrangements with ITCPM, ITC Finance Pty Ltd or the Nominated Financier, with terms and conditions that differ in any way from those set out in paragraphs 52 to 62 of this Ruling.

64. This Ruling does not apply if a Grower enters into a finance agreement that 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 ITCPM, ITC Finance Pty Ltd or the Nominated Financier, are involved or become involved in the provision of finance to Growers for the Project.

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?

65. For the amounts set out in paragraph 23 of this Ruling to constitute allowable deductions the Growers afforestation activity must amount to the carrying on of a business of primary production.

66. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on of a business of primary production.

67. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

68. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the ITC Diversified Forestry Project Stage 1. As TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

69. Having applied these principles to the arrangement set out above, a Grower in the ITC Diversified Forestry Project Stage 1 is accepted to be carrying on a business of growing and harvesting timber for sale.

The Simplified Tax System

Division 328

70. 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.

71. 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 (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Establishment Services Fees

Section 8-1

72. The Establishment Services Fee is deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Establishment Services Fees (see paragraphs 49 to 51 of TR 2000/8).

73. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Subject to the prepayment provisions (see paragraphs 78 to 82 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred (Note: The meaning of incurred is explained in Taxation Ruling TR 97/7).

74. Some Growers may finance their participation in the Project through a Loan Agreement with ITC Finance Pty Ltd or the Nominated Financier. Applying the same principles as that used for the Establishment Services Fee, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

75. Other than where the prepayment provisions apply (see paragraphs 78 to 85 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Administration Fee under the Terms Option

Section 40-880

76. Growers who elect to pay their Grower's contribution under the Terms Payment Agreement must pay an Administration Fee of \$275. This expenditure does not constitute a borrowing expense and is therefore not deductible under section 25-25. As it is capital in nature it is also not deductible under section 8-1.

77. However, section 40-880 will allow the Administration Fee to be deducted on a straight line basis over five income years. Section 40-880 applies to capital expenditure that is incurred in relation to a business and which is not taken into account elsewhere or denied deductibility under another provision of income tax law.

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

78. 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 income year, then it is not expenditure to which the prepayment rules apply.

79. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and section 82KZMG of the ITAA 1936 (an operative provision). References to sections 82KZME and 82KZMF of the ITAA 1936 are made only in respect their interaction with section 82KZMG and to confirm that these provisions have no application to expenditure incurred by Growers who participate in the scheme set out in this Ruling.

Application of the prepayment provisions to this Project***Sections 82KZME and 82KZMF***

80. Other than the Establishment Services Fee (see below) the fees payable under scheme to which this Product Ruling applies are payable out of harvest proceeds and the interest payable to ITC Finance Pty Ltd or the Nominated Financier is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to expenditure incurred by Growers under this scheme.

81. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays interest under a loan agreement (including loan agreements with lenders other than ITC Finance Pty Ltd or the Nominated Financier). Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion in section 82KZME that excludes them from the operation of section 82KZMF.

82. As noted in the Ruling part above, Growers who prepay interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

Section 82KZMG

83. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules in sections 82KZME and 82KZMF of the ITAA 1936 that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure incurred under a plantation forestry managed agreement. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees. Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of commencement of its eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936), and by the end of the following income year.

84. Under the Management Agreement, a Grower incurs an Establishment Services Fee consisting of expenditure of \$5,500 per Diversified Forestry Unit for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the trees.

85. The expenditure for 'seasonally dependent agronomic activities' meets all other requirements of section 82KZMG of the ITAA 1936 and, therefore, a deduction is allowable in the income year ended 30 June 2007 for the full amount of expenditure incurred by the Grower for the Establishment Services Fee.

Division 35 – deferral of losses from non-commercial business activities**Sections 35-10 and 35-55**

86. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2007 to 30 June 2027** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years:

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

87. 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.

88. 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

89. 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

90. 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).

91. The ITC Diversified Forestry Project Stage 1 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 23 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.

92. 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.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8, TR 2001/14;
TR 2002/6; TR 2002/11

Subject references:

- carrying on a business
- commencement of business
- management fee expenses
- non-commercial losses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- taxation administration

Legislative references:

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
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- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 40-880
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- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
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- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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- ITAA 1936 Pt IVA
- ITAA 1936 177A
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- ITAA 1936 177D
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- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

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