



PR 2006/18 - Income tax: Primary Yield Eucalypt Project No. 9 - Pre 30 June Growers (to 30 June 2006)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *22 March 2006*



Product Ruling

Income tax: Primary Yield Eucalypt Project No. 9 – Pre 30 June Growers (to 30 June 2006)

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

This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a taxation provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any under-paid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products and how the product fits an existing portfolio. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme is not carried out as described, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the scheme will be carried out as described in this Product Ruling.

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the scheme has been implemented as described below and to ensure that the participants in the scheme include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Ruling is about

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

Relevant taxation provision(s)

2. The tax laws dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 of the ITAA 1997;
 - section 17-5 of the ITAA 1997;
 - 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);
 - sections 82KZME to 82KZMG (ITAA 1936); and
 - Part IVA (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. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies consists of those entities more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme specified below on or after the date this Ruling is made. They will have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the scheme. In this Ruling, these persons are referred to as 'Growers'.

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

- entities who intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- entities who participate in the Project through offers made other than through the Product Disclosure Statement;
- entities who participate in the Project as 'Joint Venture Growers' described in paragraph 29;
- entities who finance their participation in the Project through loans with Environinvest Ltd;
- entities who finance their participation in the Project through loans with Primary Yield Finance Pty Ltd other than those loans described at paragraphs 50 and 53 of this Product Ruling; and
- entities who are accepted to participate in the Project after 30 June 2006.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 57.

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 22 March 2006, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the scheme covered by the private ruling has not commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all 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

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

- Application for a Product Ruling dated 2 November 2005 as constituted by documents provided on 5 November 2005, 9 December 2005, 16 January 2006, 25 January 2006, and additional correspondence dated 11 November 2005, 19 December 2005, 22 December 2005, 28 December 2005, 9 January 2006, 11 January 2006, 9 February 2006, 20 February 2006, 22 February 2006, 6 March 2006, 7 March 2006 and 9 March 2006;
- Draft **Product Disclosure Statement** for Primary Yield Eucalypt Project No. 9 (the 'PDS'), issued by Environinvest Limited, A.B.N. 81 080 743 791 (as 'the Responsible Entity') ('Environinvest'), received 5 November 2005 and amended 16 January 2006;
- Draft **Primary Yield Eucalypt Project No. 9 Constitution** ('the Constitution'), received 5 November 2005 and amended 16 January 2006;
- Draft Compliance Plan for Primary Yield Eucalypt Project No. 9, received 5 November 2005 and amended 7 March 2006;
- Draft **Primary Yield Eucalypt Project No. 9 Management Agreement** between Environinvest Ltd (as 'the Manager') and the Grower, received 5 November 2005 and amended 16 January 2006;
- Draft **Primary Yield Eucalypt Project No. 9 Grower Lease** ('the Grower Lease') between Environinvest Ltd (as 'the Lessor') and the Grower, received 5 November 2005 and amended 16 January 2006;
- Draft **Primary Yield Eucalypt Project No. 9 Agreement for Lease** between Environinvest Ltd (as 'the Lessor') and the Grower, received 5 November 2005 and amended 7 March 2006;
- Draft Head Lease agreement between Environinvest Ltd and Environinvest Land Lease Pty Ltd, received 5 November 2005;
- Draft Sub-Lease agreement between Environinvest Land Lease Pty Ltd and Environinvest Ltd, received 5 November 2005;
- Draft **Instalment Agreement** between the Manager and the Grower, received 5 November 2005;

- Draft **Primary Yield Finance Pty Ltd Loan Application Form and Loan Agreement** between Primary Yield Finance Pty Ltd (as 'Lender') ('Primary Yield Finance') and the Grower (as 'Borrower'), received 5 November 2005 and amended 25 January 2006; and
- Draft Heads of Agreement, received 16 January 2006.

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

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

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

Overview

18. The salient features of the Primary Yield Eucalypt Project No. 9 are as follows:

| | |
|---|---|
| Location | Victoria and South Australia |
| Type of business to be carried on by each participant | Commercial growing and cultivating of Tasmania Blue Gum, <i>Eucalypt globulus</i> , for the purpose of harvesting and selling wood for woodchips. |
| Size of each Allotment | A parcel or parcels of land of a size, as determined by the Manager, acting reasonably, capable of producing a yield of <i>Eucalyptus globulus</i> of 250m ³ within ten years from the date of planting. |
| Minimum allocation per participation | 1 Allotment |
| Term of the Project | 10-12 years |
| Initial cost per Allotment | \$6,270 |
| Ongoing costs (payment deferred until harvest) | Maintenance Fees; and Rent. |
| Other costs | The harvest cost; Performance Bonus Fee of 25% of the amount received above the Benchmark per Allotment; and Insurance, including a 10% service fee, based on the premium; and Where applicable, a Loan Establishment Fee and interest. |

19. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Environinvest has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project.

20. An offer to participate in the Project will be made through a PDS. The offer will invite participants to subscribe for a minimum one 'Allotment' in the Project.

21. To participate in the Project participants must complete the 'Application Form' and the 'Power of Attorney' form attached to the PDS and pay the 'Initial Fee'. The 'Initial Fee' will be held by the Responsible Entity initially in the 'Project Account' as bare Trustee for the 'Applicant' and will be released to the Responsible Entity in accordance with clause 8 of the Constitution when certain specified criteria have been met.

22. Under the Power of Attorney, 'Applicants' who are accepted to participate in the Project will enter into agreements with Environinvest and its associates, to establish, manage, harvest and sell a commercial plantation of *Eucalyptus globulus* trees and carry on a commercial business of afforestation during the 'Term' of the Project.

23. Growers will enter into a Grower Lease with Environinvest for a minimum of one 'Allotment'. An 'Allotment' is an identifiable area of 'Land' determined by the Lessor, acting reasonably, as being capable of producing a yield of Eucalyptus Globulus of 250m³ within ten years from the date of planting.

24. The Grower Lease gives Growers the right to access their 'Allotment(s)' during the term of the Project to carry on their 'Business' of establishing, maintaining, harvesting, and selling their 'Trees'.

25. Under the Management Agreement each Grower will engage Environinvest to manage their 'Business' during the term of the Project.

26. Growers whose 'Applications' are accepted on or before 30 June 2006 will commence participation as 'Pre 30 June Growers (to 30 June 2006)'. **This Ruling only applies in respect of 'Pre 30 June Growers (to 30 June 2006)'. Note that separate Product Rulings have been issued for Growers who enter into the Project from 1 July 2006 to 31 December 2006 and 1 January 2007 to 30 June 2007 respectively.**

Constitution

27. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Agreement for Lease, Grower Lease, and Management Agreement are annexations of the Constitution. These agreements will be executed on behalf of each Grower who has signed the 'Application Form' and 'Power of Attorney' form in the PDS and who is accepted to participate in the Project. After acceptance and execution of the agreements, each Grower is bound by the Constitution, the Management Agreement, the Agreement to Lease (if applicable) and the Grower Lease. The Responsible Entity will keep a register of all Growers that are accepted to participate in the Project.

28. Among the other things, the Constitution sets out details summarised as follows:

- appointment of the Responsible Entity as the Grower's irrevocable agent, representative and attorney (clause 3);
- procedures relating to 'Applications' (clause 7);
- the discretion of the Responsible Entity to refuse an 'Application' (clause 7.3);
- preparation and execution of the 'Project Documents' by the Responsible Entity (clause 9);
- the Responsible Entity's powers and duties (clause 14);
- the setting up and maintenance of a Register of Growers (clause 15);
- resolution of complaints made by the Growers in relation to the Project or the Responsible Entity (clause 21);
- retirement and removal of the Responsible Entity (clause 26);
- procedures for calling a meeting of Growers (clause 29);
- 'Joint Venture Interests' (clause 34); and
- events and procedures for winding up the Project (clause 35).

Joint Venture

29. Clause 34 of the Constitution outlines that two applicants may participate in the Project as 'Joint Venture Growers'. **The tax implications for Growers who participate in the Project as 'Joint Venture Growers' are not covered by this Product Ruling.**

Compliance Plan

30. As required by the *Corporations Act 2001*, Environinvest, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Environinvest manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease and Sub-Lease agreements

31. Under the Head Lease agreement, Environinvest will lease the 'Land' to Environinvest Land Lease Pty Ltd, which will lease the 'Land' back to Environinvest under the Sub-Lease agreement. To protect the Growers' interests in the 'Land' under the Grower Leases both agreements will be registered with the applicable land title office.

Grower Lease

32. Each Grower will enter into a Grower Lease (being a further sub-lease under the Sub-Lease agreement) with Environinvest (as Lessor). Under clauses 2 and 3, Environinvest grants a lease to the Grower for the purpose of carrying on a 'Business' including planting, growing, tending, caring for and harvesting of the 'Trees' for commercial profit. Subject to the occurrence of certain termination events, the term of the Grower Lease is from the 'Execution Date' until the day after completion of 'Harvesting Services'.

33. Under clause 4 of the Grower Lease, Environinvest acknowledges that the 'Trees' are the property of the Grower during the term of the Grower Lease. During the term of the Grower Lease the Grower grants a general lien to Environinvest over their 'Trees' for any sum owing under the Agreement (clause 15).

34. Among other things, the Grower Lease also sets out:

- the annual 'Rent' payable by Growers (clause 5 and Item 5 of the Schedule);
- the right and obligations of the Grower (clause 3, 4 and 6) and the rights and obligations of Environinvest (clause 7);
- provisions relating to early termination of the Grower Lease by the Grower in the case of damage or destruction of the Grower's 'Trees' and the rights and obligations of the parties following such termination (clause 8);
- what constitutes an 'Event of Default' and the rights of the Lessor to terminate the Grower Lease if the Grower is in default (clause 14); and
- procedures relating to dispute resolution (clause 16).

Agreement for Lease

35. Where 'Land' is not available for lease to a Grower on the 'Commencement Date', the Grower, will be required to enter into an 'Agreement for Lease' with Environinvest prior to the execution of a Grower Lease.

36. Pursuant to the terms of the Agreement to Lease, Environinvest agrees that:

- (a) within nine months after the 'Commencement Date'; and
- (b) within a period of the time that is reasonably sufficient to enable the Manager to complete the 'Establishment Service' and 'Planting services' pursuant to the Management Agreement on or before the end of the first 'Subsequent Year' (whichever is the earlier),

it will source and identify 'Land' that is suitable for the purpose of the Project and acquire an interest in the 'Land' that is sufficient to grant a Grower Lease to the Grower.

Management Agreement

37. Each Grower engages the Manager as an independent contactor to provide the 'Establishment Services', 'Planting Services', 'Maintenance Services' and 'Harvesting Services'. The Manager is also appointed as sole agent to procure the sale of the Grower's 'Trees' (clause 2).

38. The 'Establishment Services' (defined in clause 1.1) will be carried out by the Manager within 12 months of the 'Commencement Date' (clause 4(a)).

39. Commencing as soon as practical after the completion of the 'Establishment Services', the Manager will provide the 'Planting Services' to the Growers' 'Allotments'. The 'Planting Services' (defined in clause 1.1) are to be completed within 12 months of the 'Commencement Date' (clause 4(b)).

40. In each 'Subsequent Year' the Manager will carry out the 'Maintenance Services' in accordance with good silvicultural practice (clause 4(c)) and the Harvesting Services in those years it considers appropriate (clause 4(d)).

41. At Grower's expense the Manager shall endeavour to procure an insurance policy against destruction or damage of the Grower's 'Allotments'. The Manager will invoice the Grower for the relevant insurance premium together with a service fee of 10% of the amount of the premium for each year or part thereof (clause 11).

42. Among other things, the Management Agreement also sets out:

- the Manager's entitlement to be paid the Initial Fee, the Maintenance Fees, the 'Performance Bonus Fee', and Harvesting Expenses (clause 5);

- the rights and duties of the Manager and each Grower (clauses 6, 7, 9 and 10);
- the right of the Manager to engage subcontractors to carry out services required under the Management Agreement (clause 13);
- provisions dealing with default and termination (clause 19); and
- dispute resolution procedures (clause 21).

Fees

43. Under the Management Agreement the 'Initial Fee' payable for the 'Establishment Services' and the 'Planting Services' is \$6,270. The fee is payable at the time of application (clause 5.1).

44. There are no ongoing payments for the 'Rent' or the 'Maintenance Fee'. Payment of the 'Maintenance Fee' and the annual 'Rent' is deferred until the end of the 'Harvest Period' and are payable by the Grower to the Manager from the 'Grower's Entitlement' of 'Net Harvest Proceeds'. If the 'Grower's Entitlement' is insufficient to pay these amounts the Grower must pay the balance of the deferred fees from its own resources. The 'Maintenance Fee' and the 'Rent' are payable on demand where the Management Agreement is terminated because of a 'Force Majeure' or immediately if the Grower is in default (clause 5.2).

45. The Manager may also be entitled to a 'Performance Bonus Fee' of 25% payable out of the 'Grower's Entitlement' where the 'Net Harvest Proceeds' exceed a 'Benchmark' return. The 'Performance Bonus Fee' is determined using a formula at Item 6 of the Schedule to the Management Agreement (clause 5.3).

46. Growers are also required to pay the Manager for insurance (clauses 5.4 and 11) and harvesting expenses (clause 5.5).

Pooling of 'Trees' and distribution of proceeds

47. Both the Constitution (clause 19) and the Management Agreement (clause 6) set out the arrangements relating to the pooling of amounts from the sale of the Growers' 'Trees' and the distribution of 'Net Harvest Proceeds' from that sale or from insurance proceeds. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Trees' or insurance proceeds to the pool making up the 'Net Harvest Proceeds' are entitled to benefit from distributions from those proceeds; and

- 'Trees' can only be pooled with the Growers' 'Trees' planted during the autumn planting season in the 2007 calendar year.

Finance

48. A Grower who does not pay the 'Initial Fee' in full upon application and who does not receive an approval to pay its fees under the Instalment Agreement (see below), can borrow from Primary Yield Finance, or from an independent lender external to the Project. **A Grower who funds its participation in the Project through loans with Environinvest Ltd is not covered by this Product Ruling and is not entitled to the tax benefits set out in this Product Ruling.**

49. Only the Instalment Agreement Arrangement set out in paragraphs 54 to 55 and finance arrangements with Primary Yield Finance Pty Ltd that do not differ from the arrangement described in paragraphs 50 to 53 are covered by this Product Ruling. No other finance arrangements are covered by this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

Finance offered by Primary Yield Finance Pty Ltd

50. A Grower (called 'the Borrower' in the Primary Yield Finance Pty Ltd Loan Application Form and Loan Agreement) can borrow from Primary Yield Finance (as the 'Lender') provided that the conditions contained in clause 2 and the Schedule of the 'Loan Agreement' are satisfied.

51. Subject to Primary Yield Finance accepting the 'Borrower's' application, the 'Borrower' will be bound by the terms and conditions of the Loan Agreement upon signing the Loan Application Form and Loan Agreement and after the Loan Application Form and Loan Agreement are executed.

52. The deposit required for the application of the 'Loan' will vary, at the absolute discretion of the 'Lender'. Similarly the 'Term' and 'Interest Rate' of the 'Loan' may also be varied within good commercial terms at the absolute discretion of the 'Lender'. Although details of Loan Agreements with Primary Yield Finance may vary, Growers are not covered by this Product Ruling where they enter into a Loan Agreement with Primary Yield Finance which includes any of the following features:

- the 'Term' of the loan exceeds 8 years;
- repayments of the 'Loan' are not made in equal monthly repayments of principal and interest; or
- the 'Term' of the Loan Agreement includes an interest only period.

53. Common features of the Loan Application Form and Loan Agreement offered by Primary Yield Finance require that:

- the Grower's application to participate in the Project has been accepted by Environinvest;
- the Grower pays a 'Loan Establishment Fee' of \$250;
- Primary Yield Finance will take security over the Growers 'Allotments' and 'Trees';
- additional interest will be charged at the Commonwealth Bank 55 Day Interest Free Standard VISA Credit Card Rate on overdue amounts due and payable;
- Growers agree to make equal monthly repayments of the 'Instalment Amount', which is stipulated in Item 10 of the Schedule, on each 'Date of Payment' over the 'Term' of the 'Loan' as detailed in the Schedule.

Instalment Agreements with Environinvest

54. Where Environinvest accepts that the 'Initial Fee' can be paid under the Instalment Agreement, the Grower must complete an Instalment Agreement. Environinvest reserves the right to either accept or reject the application.

55. If the Instalment Agreement is accepted by Environinvest, the Grower will be required to pay their 'Application Money' on the date and the amount specified in Item 7 of the Schedule in the Instalment Agreement, or as otherwise agreed by the Grower and the Manager from time to time provided that the 'Application Money' must be paid in full within 12 months of the 'Commencement Date' by the 'Final Repayment Date'.

Other qualifications relating to finance arrangements

56. Other than where the 'Application Money' is paid under an Instalment Agreement, Growers cannot rely on any part of this Ruling if the 'Application Money', is not paid in full on or before 30 June 2006 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted by Environinvest, and that application is subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to Environinvest by the relevant lending institution on or before 30 June 2006.

57. This Ruling also does not apply if a 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 Primary Yield Finance, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

58. Subject to paragraph 8, this Ruling applies only to a Grower who is accepted to participate in the Project on or before 30 June 2006 as a 'Pre 30 June Growers (to 30 June 2006)' and who has executed a Management Agreement, a Grower Lease and, where necessary, an Agreement for Lease on or before that date.

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

60. 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***

61. 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*.

62. 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***

63. 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***

64. 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 the 'Initial Fee', interest and the 'Loan Establishment Fee'**Section 8-1**

65. A Grower who is accepted to participate in the Project on or before 30 June 2006 may claim tax deductions, on a per 'Allotment' basis, under section 8-1 of the ITAA 1997, for the revenue expenses set out in the Table below.

| Fee Type | Year ended 30 June 2006 | Year ended 30 June 2007 | Year ended 30 June 2008 |
|---|--|--|--|
| 'Initial Fee' | \$6,270 See Notes (i) & (ii) | | |
| Interest on the loans with Primary Yield Finance described in paragraphs 53 to 56 | As incurred See Notes (iii) & (iv) | As incurred See Notes (iii) & (iv) | As incurred See Notes (iii) & (iv) |
| Loan 'Establishment Fee' for loans with Primary Yield Finance | See Note (v) | See Note (v) | 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 (for example input tax credits): Division 27.
- (ii) Under section 82KZMG of the ITAA 1936 the 'Initial Fee' is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 91 to 93) and is deductible in the income year in which it is incurred.
- (iii) Loan arrangements entered into with financiers other than Primary Yield Finance are outside the scope of this Ruling. Growers who borrow from lenders other than Primary Yield Finance may request a private ruling on the deductibility of the interest incurred.

- (iv) This Ruling does not apply to Growers who choose or who are required to prepay interest under a loan agreement (including loans from lenders other than Primary Yield Finance). All Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 89 to 96 as those rules may be applicable if interest is prepaid. Any Grower who prepays interest may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The 'Loan Establishment Fee' of \$250 payable to Primary Yield Finance is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Primary Yield Finance is outside the scope of this Ruling.

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

Section 35-55 – exercise of Commissioner's discretion

66. A Grower who is an individual accepted into the Project by 30 June 2006 as a 'Pre 30 June Grower (to 30 June 2006)' may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending:

- 30 June 2006 to 30 June 2017; or
- the income year preceding the 'Harvest Year' (whichever occurs sooner).

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 are incurred.

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

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

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME and 82KZMF;

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- 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

22 March 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?

68. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the Primary Yield Eucalypt Project No. 9 must amount to the carrying on of a business of primary production.

69. Where there is a business, or a future business, the gross proceeds from the sale of the 'Trees' 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.

70. For schemes such as that of the Primary Yield Eucalypt Project No. 9, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As 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.

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

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

72. In this Project, each Grower enters into a Management Agreement and a Grower Lease, and in some situations, where land is not immediately available, an Agreement for Lease.

73. Under the Grower Lease each individual Grower will have rights over a specific and identifiable area of land capable of producing a yield of *Eucalyptus Globulus* of 250m³ within ten years from the date of planting. The Grower Lease provides the Grower with an ongoing interest in the specific trees on the Allotment for the 'Term' of the Project. Under the Grower Lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Grower Lease allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

74. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain a 'Business' on the Grower's identifiable area of land during the 'Term' of the Project. The Manager has provided evidence that it has the appropriate professional skills and credentials to provide the 'Services' to establish and maintain the 'Trees' on the Grower's behalf.

75. The Manager is also engaged to harvest and sell, on the Grower's behalf, the 'Trees' grown on the Grower's 'Allotments'.

76. 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.

77. 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 'Trees' 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.

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

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

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

81. 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 Grower's afforestation activities in the Primary Yield Eucalypt Project No. 9 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

82. 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.

83. 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 the 'Initial Fee' and interest

Section 8-1

84. Consideration of whether the 'Initial Fee' is deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

85. The 'Initial Fee' associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of 'Trees') is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the 'Initial Fee'. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

Section 8-1

(i) Growers who use Primary Yield Finance as the finance provider

86. Some Growers may finance their participation in the Project through a loan facility with Primary Yield Finance. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the 'Initial Fee' under the Management Agreement.

87. The interest incurred for the year ended 30 June 2006 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations that will continue to be directly connected with the gaining of 'business income' from the Project. Interest on the Primary Yield Finance Loans described in paragraphs 50 to 53 will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Growers who DO NOT use Primary Yield Finance as the finance provider

88. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Primary Yield Finance is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

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

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

90. For the Scheme that applies to this Product Ruling, only sections 82KZL (an interpretive provision) and 82KZMG of the ITAA 1936 are relevant (but see paragraphs 94 to 95 for comments on the possible application of sections 82KZME and 82KZMF of the ITAA 1936).

Section 82KZMG

91. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules 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.

Application of the prepayment provisions to this Project

92. Under the Management Agreement, a Grower incurs an 'Initial Fee' consisting of expenditure of \$6,270 that:

- is for 'seasonally dependent agronomic activities'; and
- meets the other requirements of section 82KZMG of the ITAA 1936.

93. As this expenditure meets the requirements of section 82KZMG of the ITAA 1936 a Grower can claim an immediate deduction for the 'Initial Fee' in the income year in which the amount is incurred.

Sections 82KZME and 82KZMF

94. Under the Scheme to which this Product Ruling applies fees for Rent under the Grower Lease and the Maintenance Fee and the Harvesting Expenses under the Management Agreement are only payable from the proceeds of the harvest and sale of the 'Trees', or from insurance proceeds. Interest payable under the finance packages offered by Primary Yield Finance is incurred and payable monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Scheme.

95. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project chose to prepay interest under a loan agreement with Primary Yield Finance, or chose or is required to prepay interest under a loan agreement with a lender other than Primary Yield Finance. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

96. Growers who choose to 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.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – exercise of Commissioner's discretion***

97. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 65 the Commissioner has applied the principles set out in 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;
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

98. 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

99. 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.

Part IVA – general tax avoidance provisions

100. 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).

101. The Primary Yield Eucalypt Project No. 9 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 65 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.

102. 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 'Trees'. 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 92/20; TR 97/11; TR 98/22;
TR 2000/8; TR 2001/14;
TR 2002/6; TR 2002/11;
TD 93/34; TD 2003/12

Subject references:

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

- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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- ITAA 1936 177A
- ITAA 1936 177C
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NO: 2005/16850
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ timber