



PR 2006/4 - Income tax: Willmott Forests Professional Investor - 2006 Project

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



Product Ruling

Income tax: Willmott Forests Professional Investor – 2006 Project

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

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

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

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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

What this 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, which take part in the scheme to which this Ruling relates. In this Ruling this scheme is referred to as the Willmott Forests Professional Investor – 2006 Project' or simply as 'the Project'.

Relevant taxation provision(s)

2. The tax laws dealt with in this Ruling are:

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

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Grower') to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

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

Class of entities

7. The class of entities to which this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling and which enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the scheme. In this Ruling, each of these entities, referred to as 'Growers', will be 'wholesale clients' for the purposes of section 761G of the *Corporations Act 2001*.

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

- entities which 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 which elect to opt out of the marketing and harvesting arrangement with Willmott Forests Limited and organise the harvesting and marketing of timber produced from their 'Hectares';
- entities which choose to pay by transferring property to the Manager, as set out in clause 4.2 of the Investment Deed of the Willmott Forests – Professional Investor – 2006 Project;
- entities which participate in the Project through offers made other than through the Information Memorandum;
- Willmott Forests Limited or its associates; and
- entities which 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 52.

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

Scheme

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

- Application for a Product Ruling received 11 March 2005, as constituted by documents provided on 11 March 2005, 13 April 2005, 31 October and additional correspondence (including e-mails) dated 13 April 2005, 26 October 2005, 12 December 2005 and 31 January 2006;
- Draft Willmott Forests Professional Investor – 2006 Project Information Memorandum, received by the Tax Office on 31 October 2005 ('Information Memorandum');
- Draft Investment Deed of the Willmott Forests – Professional Investor – 2006 Project ('Investment Deed') issued by WFL undated, received by the Tax Office 11 March 2005;
- Proforma **Lease Agreement** between WFL and the Grower received by the Tax Office on 11 March 2005;
- Proforma **Pre-lease Agreement** between WFL and the Grower, received by the Tax Office 11 March 2005;
- Proforma **Forestry Management Agreement** between WFL and the Grower, received by the Tax Office 13 April 2005;
- Draft Forestry Right Agreement received by the Tax Office 11 March 2005;
- Wood Purchase Agreement between WFL and Willmott Timbers Pty Ltd, dated 31 January 2005, received by the Tax Office 11 March 2005;
- Wood Purchase Agreement between WFL and Willmott Forest Products Pty Ltd, dated 31 January 2005, received by the Tax Office 11 March 2005; and
- **Loan Agreement [15 Year Loan Agreement (P&I)]** between Willmott Finance Pty Ltd ('Willmott Finance') and the Grower, received by the Tax Office on 31 October 2005.

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. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936.

17. In accordance with the above documents, a Grower who participates in the scheme must be a wholesale client. **This Ruling does not apply unless the Grower is a wholesale client for the purposes of section 761G of the Corporations Act 2001.** The meaning of wholesale client is explained in the Information Memorandum for this Project.

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

Overview

19. The scheme is called the Willmott Forests Professional Investor – 2006 Project and is summarised as follows:

Location	Bombala region of south east NSW and Murray Valley region of NSW.
Type of business to be carried on by each participant	Commercial cultivation of <i>Pinus radiata</i> for the purpose of harvesting as quality sawlogs.
Number of hectares offered for cultivation	Unlimited.
Size of each interest	Minimum of 15 'Hectares'.
Trees per hectare	1,000 seedlings.
Term of the Project	25 years.
Initial cost per hectare	\$7,700.
Ongoing costs	Maintenance and lease rental costs will be a percentage of 'Gross Timber Proceeds' from the 'Thinnings' and the 'Clear Fell' or from insurance proceeds in the event of 'Material Damage' to the 'Trees'.
Other costs	Compulsory insurance premiums from Year 3; Harvesting Fee, of 1% of 'Gross Timber Proceeds'; Interest payments, under the Loan Agreement; and Any other amounts agreed upon in writing between WFL and Growers.

20. The Project is an unregistered managed investment scheme under the *Corporations Act 2001*. The objective of the Project is to establish and manage long term commercial plantations of softwood for the purpose of harvesting for sale.

21. Under the Information Memorandum, applicants apply for a minimum of 15 'Hectares'. Applicants are accepted to participate in the Project as Growers and enter into a Lease Agreement or Sublease Agreement and a Forestry Management Agreement with WFL. Where land is not immediately available for lease, Growers will also enter into a Pre-lease Agreement. The Project will be terminated after 'Clear Fell', a period of approximately 25 years.

Investment Deed

22. The Investment Deed establishes the Project. Growers are bound by the Investment Deed from the time of their acceptance into the Project.

23. The Investment Deed sets out the terms and conditions under which WFL agrees to act for the Growers and to manage the Project. Within 30 days of the issue of 'Hectares', WFL is required to notify an Applicant in writing of their acceptance into the Project. WFL has absolute discretion to decline or accept an Application for 'Hectares'.

24. Among other things, the Investment Deed sets out:

- the Application procedure (clause 4);
- procedures for payment (clause 5);
- the powers of the 'Manager' (clause 6);
- the rights and liabilities of the 'Manager' (clause 7);
- remuneration and expenses of the 'Manager' (clause 10);
- the 'Stocking Guarantee' (clause 12);
- insurance against damage by fire and public liability insurance (clause 13);
- procedures for the harvest and sale of the Growers' 'Trees' and distribution of the 'Gross Timber Proceeds' (clause 14);
- procedures for transfer and transmission of 'Hectares' (clause 15); and
- the period of the Project (clause 17).

Forestry Management Agreement

25. A Forestry Management Agreement is entered into between WFL and each Grower. Growers contract with the Manager to establish and maintain the plantation until maturity. The Manager may delegate its responsibilities. The Manager will use all reasonable endeavours to carry out its obligations under Part 1 and Part 2 of Schedule 1 of the Forestry Management Agreement in accordance with good forestry practices.

26. Part 1 services are for 'Preparation and Planting' and will be provided to Growers within the first 12 months of the Grower being accepted to participate in the Project. This Product Ruling will not apply to any Grower where WFL fails to complete the services under Part 1 of Schedule 1 of the Forestry Management Agreement within 12 months of the Grower's acceptance into the Project.

27. Services under Part 2 of Schedule 1 of the Forestry Management Agreement are for 'Maintenance' and will be provided from the completion of the services under Part 1 of Schedule 1 of the Forestry Management Agreement to 'Clear Fell' in the financial year ending 2031.

28. Under clause 2.3 of Part 2 the Manager will provide a 'Stocking Guarantee' for a period of 2 years (called the 'Stocking Guarantee Period') from the date the Grower is registered as the holder of 'Hectares' on the terms and conditions set out in clause 12 of the Investment Deed.

Lease Agreement and Forestry Right

29. An unregistered lease is granted by WFL (the 'Lessor') to each Grower (the 'Lessee'). WFL also grants a Forestry Right over the project land to be held by Willmott Forests Investment Management Pty Ltd as agent of the Growers. The Forestry Right will be registered with the applicable land titles office and will provide protection for the Grower's leasehold interest in the event of future dealings in the Project land.

30. Under the Lease Agreement and Forestry Right Agreement Growers have an interest in land to use their 'Hectares' for the purposes of conducting their afforestation business, including the right to harvest timber grown on their 'Hectares'. The term of the lease is for 25 years and may be extended for a further term of 5 years or until such time as the 'Trees' have been harvested and the land made good, whichever is sooner. The 'Lessee' may use the land only as part of a managed investment scheme by which Growers, participate in the establishment and maintenance of 'Trees'.

Pre-lease Agreement

31. The Pre-lease Agreement is granted by WFL to the Grower upon acceptance of an application where WFL is not immediately in a position to grant the Grower a lease (including the Forestry Right) in respect of the Grower's 'Hectares'. WFL undertakes to take all reasonable steps to grant a lease and forestry right in respect of the Grower's 'Hectares' no later than 9 months from the date of acceptance of the Grower's application.

32. Where WFL has not been able to grant a lease and forestry right to the Grower in respect of the Grower's 'Hectares' within 9 months then either party may terminate the agreement by providing 7 days prior written notice. WFL must (except in an event of default) refund any of the Grower's application monies paid in respect of the Application within 14 days of the receipt or service of the notice.

Fees

33. The total fee in consideration of the services under Part 1 of Schedule 1 of the Forestry Management Agreement is \$7,700 per 'Hectare' and is payable under one of the following payment options:

- a cash payment payable on application for a cost of \$7,700 per hectare; or
- under a Loan Agreement with Willmott Finance.

Note: Clause 4.2 of the Investment Deed also allows a Grower to make payment by transferring property to the Manager. Growers who make a payment by transferring property to the Manager will not be covered by this Product Ruling. Such Growers may apply for a private ruling on the tax consequences of their participation in the Project.

34. Under Part 2 of Schedule 1 of the Forestry Management Agreement Growers pay a fee for maintenance of 7% of the 'Gross Timber Proceeds'. This is to be paid by each Grower as and when the 'Trees' are thinned or clear felled, and sold. If the Grower receives payment under an insurance policy in respect of damage to, or destruction of, the Grower's 'Trees' on a Hectare, 7% of the insurance proceeds are to be paid to WFL within 14 days of their receipt.

35. Under the Lease Agreement the rent per 'Hectare' is an amount equal to 2% of the 'Gross Timber Proceeds' received from the harvesting of 'Trees' on each 'Hectare'. If the 'Lessee' receives payment under an insurance policy in respect of damage to, or destruction of, the 'Lessee's' 'Trees' on a Hectare, 2% of the insurance proceeds are to be paid to the 'Lessor' within 14 days of their receipt.

36. The Information Memorandum provides that unless the Manager has been notified otherwise, Growers who are accepted to participate in the Project engage the Manager to market and harvest their timber. Growers can elect to 'opt-out' of the marketing and harvesting arrangements for the Project and organise the harvesting and marketing of their own timber. Unless the Grower exercises this option, a Harvesting Fee totalling 1% of 'Gross Timber Proceeds' is payable for the Manager's fees and expenses.

37. The Manager will, in addition to any other rights it may have, be entitled to charge interest on amounts outstanding and terminate the Management and Lease Agreement for any amount that is not paid on or before the due date for payment. The Manager reserves the right to take any necessary legal action and the Grower agrees to indemnify the Manager for any costs or expenses it incurs in seeking to recover any unpaid application monies.

Pooling of 'Trees' and distribution of proceeds

38. The Investment Deed (clause 14) and the Information Memorandum set out the circumstances relating to the pooling of Growers' 'Trees' and the distribution of proceeds from that sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Trees' from a 'Harvested Hectare' to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and
- 'Trees' can only be pooled with the 'Trees' of Growers accepted to participate in the Project in the same financial year.

Application Form and Loan Agreement

39. Under the Application Form that forms part of the Information Memorandum, Growers who are accepted to participate in the Project grant WFL an irrevocable Power of Attorney. This allows WFL to execute and deliver the Pre-lease Agreement and/or Lease Agreement, the Forestry Management Agreement and, if applicable, the Loan Agreement. The Power of Attorney applies from the date of the Application being signed, to the expiration of the Project Documents.

40. The Application Form also provides Growers with an opportunity to elect to opt out of harvesting and marketing arrangements with the Manager. Growers who make this election will not be covered by this Product Ruling and may seek a private ruling on the tax consequences of participating in the Project.

41. Upon signing the Application Form a Grower who has not been approved to pay fees under a Loan Agreement acknowledges that the full fee for all Application Monies is immediately due and payable.
42. The Application Form provides that a Grower who elects to, and is accepted to pay the 'Application Monies' under the Finance Option is required to execute a Loan Agreement.
43. Under the Loan Agreement 'Monies Owing' are the Principal Amount, interest and all other monies actually or contingently owing under the Application.
44. Under a Loan Agreement, payment under the Finance Option will be on a full recourse basis. If a Grower defaults, Willmott Finance will pursue the 'Monies Owing' to the full extent permitted by law.
45. Application monies paid to WFL at the time of a Grower's Application will be deposited into a trust account known as the Willmott Forests Professional Investor Project – Application Account and will only be released and paid to WFL once the Application is accepted.

Finance

46. Growers who do not pay the fee under Part 1 of Schedule 1 of the Forestry Management Agreement in full upon Application or, who do not receive approval to pay their fees under a Loan Agreement with Willmott Finance, can fund their investment in the Project themselves, or borrow from an independent lender.
47. Financing arrangements, other than the Loan Agreement with Willmott Finance set out below, are not covered by this Product Ruling. Growers who enter into other finance arrangements may request a private ruling on the deductibility or otherwise of interest incurred under the agreement.
48. Where a Grower enters into a Loan Agreement with Willmott Finance a part payment of \$700 per hectare is payable within 90 days from the date of the Loan Agreement.
49. The balance of \$7,000 is financed under a 15 year principal and interest facility at 10.5% per annum.
50. Following acceptance of a Grower's application to participate in the Project, repayments under the Loan Agreement are payable monthly in arrears on the last business day in Victoria of each month, commencing on 31 July 2006.
51. Growers cannot rely on any part of this Product Ruling if Application Monies, other than Application Monies payable subject to a Loan Agreement, are not paid in full by 30 June 2006. Where an application is accepted by WFL subject to finance approval by any lending institution, including Willmott Finance, Growers cannot rely on this Ruling if written evidence of that approval has not been given to WFL by 30 June 2006.

52. This Ruling also does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or do not have a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Willmott Finance, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

53. This Ruling applies only to Growers who are wholesale clients for the purposes of section 761G of the *Corporations Act 2001* and who are accepted to participate in the Project on or after the date of this Ruling and on or before 30 June 2006 and who have executed a Forestry Management Agreement and either a Pre-lease or a Lease Agreement between those dates.

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

55. This Ruling does **not** apply to Growers who:

- are excluded from the Ruling as described in the Class of Entities or in the Scheme sections of this Project Ruling; or
- are accepted to participate in the Project before the date of this Ruling or after 30 June 2006.

56. 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

57. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. 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 section 328-115).

58. 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

59. For the first income year starting on or after 1 July 2005, Subdivision 61-J of the ITAA 1997 provides a 25% tax offset 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

60. 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 in the income year in which that income is derived.

Deductions for the fee under Part 1 of Schedule 1 of the Forestry Management Agreement and for interest under a Loan Agreement with Willmott Finance

Section 8-1

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

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Part 1 Fee	\$7,700 – See Notes (i) & (ii)	nil	nil
Interest payable to Willmott Finance under a Loan Agreement	As incurred See Note (iii)	As incurred See Note (ii)	As incurred See Note (iii)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoings would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) The fee under Part 1 of Schedule 1 of the Forestry Management Agreement is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 86 to 88) and is deductible under section 8-1 in the income year in which it is incurred.
- (iii) Growers who enter into a Loan Agreement with Willmott Finance for payment of the fee under Part 1 of Schedule 1 of the Forestry Management Agreement will incur interest monthly in arrears, as set out in the Agreements. The interest is deductible as incurred. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Willmott Finance, the internal financier, is outside the scope of this Ruling.

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

62. A Grower who is an individual accepted into the Project 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 2031**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

63. For a Grower who participates in the Project and incurs expenditure as required by the Forestry Management Agreement, the Lease Agreement and any Loan Agreement (as applicable) the following provisions of the ITAA 1936 have application as indicated:

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

Commissioner of Taxation22 February 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?

64. For the amounts set out in the Table to constitute allowable deductions the Grower's afforestation activities as a participant in the Willmott Forests Professional Investor – 2006 Project must amount to the carrying on of a business of primary production.

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

66. For schemes such as that of the Willmott Forests Professional Investor – 2006 Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Grower has an identifiable interest (by lease) or rights over the land (by licence) on which the Grower's 'Trees' are established;
- the Grower has a right to harvest and sell the '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.

68. In this Project, each Grower enters into a Forestry Management Agreement, a Lease Agreement and a Forestry Right Agreement (as necessary).

69. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of a minimum of 15 'Hectares' of land. The Lease Agreement provides the Grower with an ongoing interest in the specific 'Trees' on the leased area for the term of the Project. Under the Lease Agreement the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Lease Agreement allows the Manager to come onto the land to carry out its obligations under the Forestry Management Agreement.

70. Under the Forestry Management Agreement the Manager is engaged by the Grower to establish and maintain the 'Hectares' of the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the 'Hectares' on the Grower's behalf.

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

72. 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.

73. 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.

74. The pooling of 'Trees' grown on the Grower's 'Hectares' with the 'Trees' of other Growers in the Project 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 to the pool from their 'Hectares'.

75. 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.

76. The Grower's degree of control over the Manager as evidenced by the Information Memorandum, Forestry 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 'Hectares' and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

77. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence and continue regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's afforestation activities in the Willmott Forests Professional Investor – 2006 Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

78. 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.

79. Changes to the STS rules apply from 1 July 2005. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of fees under Part 1 of the Schedule to the Forestry Management Agreement

Section 8-1

80. Consideration of whether fees under Part 1 of Schedule 1 of the Forestry Management Agreement are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

81. The management fee payable under Part 1 of Schedule 1 of the Forestry Management Agreement is associated with the afforestation activities and will relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income (from the harvesting and sale of the '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 scheme. The fee appears to be reasonable. There is no capital component of the initial management fee. The tests of deductibility under the first limb of section 8-1 are met (subject to the provisions of section 82KZMG). The exclusions do not apply.

Interest deductibility

Section 8-1

(i) Growers who pay fees under a Loan Agreement with Willmott Finance

82. Some Growers may finance their participation in the Project through a Loan Agreement with Willmott 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 fees under Part 1 of Schedule 1 of the Forestry Management Agreement.

83. The interest incurred will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of 'Trees' – that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1 in the income year in which it is incurred.

(ii) Growers who enter into finance arrangements with other finance providers

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

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

85. 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.

Section 82KZMG

86. Expenditure that meets the requirements of section 82KZMG is excluded from the application of the prepayment rules that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates a 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 its eligible service period (as defined in subsection 82KZL(1)), and by the end of the following income year.

Application of the prepayment provisions to this Project

87. Under Part 1 of Schedule 1 of the Forestry Management Agreement, a Grower incurs a fee consisting of expenditure of \$7,700 per Hectare for 'seasonally dependent agronomic activities'.

88. As this expenditure meets the requirements of section 82KZMG a Grower can claim an immediate deduction for the fee under Part 1 of Schedule 1 of the Forestry Management Agreement in the income year in which the amount is incurred.

Sections 82KZME and 82KZMF

89. Under the Scheme to which this Product Ruling applies fees for rent under the Lease Agreement and fees under Part 2 of Schedule 1 of the Forestry Management Agreement are only payable as a percentage of the proceeds from harvest and sale of the 'Trees', or from insurance proceeds. Interest payable under the Loan Agreements is incurred and payable monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Scheme.

90. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project chooses to prepay interest under a Loan Agreement with Willmott Finance or chooses or is required to prepay interest under a loan agreement with a lender other than Willmott Finance.

91. 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 – Commissioner’s discretion

92. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 62, 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 discussed in paragraph 62:

- 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.

93. 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

94. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

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

96. The Willmott Forests Professional Investor – 2006 Project 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 61 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.

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

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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

Subject references:

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

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- ITAA 1936 Pt IVA
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- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
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