



PR 2007/15 - Income tax: ITC Pulpwood Project 2007

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 July 2011*



Product Ruling

Income tax: ITC Pulpwood Project 2007

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

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

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

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

[Note: This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

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

Potential participants must form their own view about the commercial and financial viability of the product. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

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

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the ITC Pulpwood Project 2007 or simply as 'the Project'.

Class of entities

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

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 26 of this Ruling on or before 30 June 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities who:

- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 30 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- enter into finance arrangements with entities associated with this project, other than those specified in paragraphs 55 to 65 of this Ruling;
- have not paid the Establishment Services Fee by 30 June 2007, where they have not entered into a finance arrangement; or

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

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 26 to 67 of this Ruling.

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

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

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Date of effect

8. This Product Ruling applies prospectively from 28 February 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 28 February 2007 until 30 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities up to 30 June 2009. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

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

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

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

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

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

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

Changes in the Law

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

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

Note to promoters and advisers

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

Goods and Services Tax

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

Ruling

Application of this Ruling

17. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 26 to 67 of this Ruling.

18. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Management Agreement and either the Land Agreement or Agreement to enter into Land Agreement, provided they are executed on or before 30 June 2007.

The Simplified Tax System (STS)

Division 328

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

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

25% entrepreneurs tax offset

Subdivision 61-J

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

Assessable income**Section 6-5 and section 17-5**

22. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

Deductions for Fees and Finance Expenses**Sections 8-1, 25-25 and 40-880, and Division 27 of the ITAA 1997, and section 82KZMG of the Income Tax Assessment Act 1936**

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

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Establishment Services Fee	\$4,400 See Notes (i) & (ii)		
Interest	As incurred See Note (iii)	As incurred See Note (iii)	As incurred See Note (iii)
Borrowing costs	Must be calculated See Note (iv)	Must be calculated See Note (iv)	Must be calculated See Note (iv)
Terms Payment Administration Fee	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated See Note (v)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST: Division 27.
- (ii) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the fee for Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 86 to 88 of this Ruling) and is deductible in the income year in which it is incurred.

- (iii) Interest under a loan agreement with ITC Finance Pty Ltd or the Nominated Financier as described at paragraphs 62 to 67 of this Ruling is deductible. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd or the Nominated Financier is outside the scope of this Ruling. However all Growers, who finance their participation in the Project, should read the discussion of the prepayment rules in paragraphs 81 to 85 of this Ruling as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.
- (iv) The Loan Application Fee of \$250 plus 0.4% of the loan amount is a borrowing cost and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd or the Nominated Financier is outside the scope of this Ruling.
- (v) The Terms Payment Administration Fee payable to ITCPM for the Terms Arrangement is not deductible in full when it is incurred. Under section 40-880 it is deductible on a straight line basis over five income years (see paragraphs 79 to 80 of this Ruling).

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

Section 35-55 – exercise of Commissioner's discretion

2006-07 to 2016-17 income years

24. Subject to the Project being carried out in the manner described in this Ruling, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for Growers as it applied at 28 February 2007, the date this Ruling was made, for the 2006-07 to 2016-17 income years. 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.

2017-18 to 2021-22 income years

24A. For the 2017-18 to 2021-22 income years, the Commissioner will exercise the discretion in subsection 35-55(1) once the following conditions are satisfied:

- the Grower carried on their business of afforestation during the income year; and
- the business activity that is carried on is not materially different to that in the scheme described in this Ruling; and
- the Grower has incurred a taxation loss for the income year from carrying on that business activity.

24B. If these conditions are met for the 2017-18 to 2021-22 income years, the Commissioner will exercise the discretion for that year under:

- paragraph 35-55(1)(b) for a Grower in the Project who satisfies the income requirement in subsection 35-10(2E); and
- paragraph 35-55(1)(c) for a Grower in the Project who does not satisfy the income requirement in subsection 35-10(2E).

24C. If the Commissioner determines that the discretion will not be exercised for a particular year or years the Grower will be informed of that decision and the reasons. In any year where the discretion is not exercised losses incurred by a Grower will be subject to the loss deferral rule in section 35-10 and the Grower will not be able to offset the losses from the Project against other assessable income.

24D. The issue of this Product Ruling of itself does not constitute the exercise of the Commissioner's discretion in subsection 35-55(1) for any income year.

Prepayment provisions and anti-avoidance provisions

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

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

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

Scheme

26. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling as constituted by documents dated 18 October 2006 and additional correspondence, including e-mails, dated 20 October 2006, 23 November 2006, 13 December 2006, 19 December 2006, 21 December 2006, 11 January 2006, 11 January 2007, 1 February 2007, 17 February 2011, 18 March 2011, 20 April 2011, 23 May 2011 and 14 June 2011;
- Draft **Product Disclosure Statement** to be issued by ITC Project Management Limited (Responsible Entity), received 21 December 2006;
- ITC Pulpwood Project 2007 **Scheme Constitution**, received 1 February 2007;
- Compliance Plan for ITC Project Management Limited – ITC Pulpwood Project 2007, received 18 October 2006;
- Draft **Land Agreement** between ITC Project Management Ltd (Lessor) and the Grower, received 18 October 2006;
- Draft **Memorandum (Land Agreement Provisions)** for the ITC Teak Project 2006, received 18 October 2006;
- Draft **Agreement to enter into Land Agreement**, received 18 October 2006;
- Draft **Management Agreement** between ITC Project Management Limited and the Grower, received 18 October 2006;
- Draft **Memorandum (Management Agreement Provisions)** for the ITC Teak Project 2006, received 21 December 2006;
- Draft **Tree Farm Loan Agreement** between the Nominated Financier, ITC Finance Pty Ltd and/or their nominees (the Lender) and 'the Borrower', received 18 October 2006;
- Draft Tree Farm Loan Deed Between ITC Finance Pty Ltd and The Nominated Financier, received 18 October 2006;
- **Application booklet** for the ITC Pulpwood Project 2007, received 15 December 2006;

- Draft Service Agreement between Australian Plantation Timber Limited and Integrated Tree Cropping Limited, received 18 October 2006;
- Sample Pulpwood Treefarm Management Plan, received 18 October 2006;
- Draft Independent Forester's Report, received 18 October 2006;
- Final **Product Disclosure Statement** issued by ITC Project Management Limited on 14 March 2007; and
- Draft **Deed of Variation of Land Agreement for the ITC Pulpwood Project 2007**, received 17 February 2011.

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

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

28. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

29. Following is a summary of the scheme:

Location	<ul style="list-style-type: none"> • Esperance region of Western Australia; and/or • Albany and Bunbury regions of Western Australia; and/or • Green Triangle region of western Victoria and south-eastern South Australia; and/or • Bundaberg/Gladstone or Mackay regions of central Queensland.
Type of business to be carried on by each participant	Commercial growing and cultivation of eucalypt and or other species for the purpose of harvesting the timber for high grade pulpwood.
Number of hectares offered for	Approximately 10,000 hectares

cultivation	
Size of each Plantation Unit	Between 0.8 hectares to 1.2 hectares
Minimum Investment	One Plantation Unit
Term of the Project	Until final harvest proceeds are distributed in approximately 2021-22
Initial cost	\$4,400
Ongoing costs	Compulsory insurance until harvest commencement date and related insurance administration fee
	Deferred Management Fees – (25.74% of Harvest Proceeds)
	Item 2 Schedule 3 of the Memorandum (Management Agreement Provisions)
Other costs	Deferred Land Fees – (4.51% of Harvest Proceeds) Schedule 2 of the Memorandum (Land Agreement Provisions)
	Cost of Harvest and Marketing – Payable from Project Proceeds
	Compulsory Insurance – Payable from Project Proceeds

30. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is ITC Project Management Ltd (ITCPM). Under the ITC Specialty Timber Project Product Disclosure Statement 2007 (PDS), ITCPM proposes to offer interests called 'Plantation Units'. There is no minimum subscription for the Project.

31. The PDS offers a choice of four projects to be managed by the Responsible Entity. This Ruling only applies to the ITC Pulpwood Project 2007.

32. The land will be assessed by ITCPM as being suitable for the establishment of commercial plantations in accordance with a methodology endorsed by the Independent Forester. The land for the project will primarily be leased from a related entity, ITC Timberlands Ltd.

33. Growers participating in the scheme will enter into a Land Agreement with ITCPM. The Land Agreement is executed over an identifiable area of land called a 'Plantation Unit' located at the various properties utilised by the project.

34. A Plantation Unit is the area of land that is expected to produce 225 cubic metres of Pulpwood. The area of the Plantation Unit varies across geographic regions and from property to property depending upon the estimated productivity of the property. Each Plantation Unit will have an area of between of 0.8 hectares to 1.2 hectares.

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

36. Growers will also enter into a Management Agreement with ITCPM for the management of their Plantation Units. ITCPM will be responsible for establishing, cultivating and harvesting the trees. The trees are expected to be harvested approximately 10 years after planting. ITCPM will arrange for the sale of the timber.

36A. If, within 12 months of planting, an area is damaged by pests or disease to the extent that it will materially affect timber yield, the Responsible Entity will re-establish the damaged area at its cost (clause 5.2 of the final PDS). In circumstances where successful re-establishment will require the reallocation of an affected Grower's Plantation Unit, a Deed of Variation of Land Agreement will be entered into to give effect to the reallocation.

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

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

Constitution

39. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which ITCPM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

40. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity, which shall deposit those moneys into an Application Fund, (clause 5.1). The Application Moneys will be released when ITCPM is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 8 and 9.1).

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

42. The Responsible Entity will also:

- prepare the Management Agreement and the Land Agreement (clause 6);
- keep a register of Growers (clause 28);
- appoint an auditor(s) of the Project (clause 33); and
- maintain records and prepare accounts for the Project (clause 34).

Compliance Plan

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

Interest in land

Land Agreement

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

45. Under the Land Agreement Growers acquire an interest in land called a Plantation Unit. The size of each Plantation Unit will be between 0.8 and 1.2 hectares. Growers will have a right to use their Plantation Unit during the Term of the Project for the purpose of conducting their afforestation business.

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

- not use the Plantation Units for a purpose other than growing and harvesting trees (clause 4(a));
- comply with sound silvicultural and environment practices adopted within the forestry industry (clause 4(b)); and
- comply with all laws and regulations relating to the use and occupancy of the Grower's Plantation Units (clause 4(c)).

Agreement to enter into Land Agreement

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

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

Deed of Variation of Land Agreement

48A. Where the Responsible Entity has executed a Land Agreement on behalf of a Grower and a need arises to reallocate that Grower's Plantation Unit(s), a Deed of Variation of Land Agreement will be executed by the Responsible Entity on behalf of the Grower. The Deed of Variation of Land Agreement will maintain the Grower's identifiable interest in land following the reallocation of the Grower's Plantation Unit(s).

Management Agreement

49. A Management Agreement will be entered into between ITCPM and the Grower. The Agreement provides that each Grower appoints ITCPM to perform services under the Agreement. ITCPM must perform the services in a proper and efficient manner and will maintain access to such staff, personnel, consultants and other specialist services as may be reasonably necessary (clause 3.1). The provisions of the Memorandum (Management Agreement Provisions) are incorporated in the Management Agreement.

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

Item 1 – Establishment Services

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

Item 2 – Management Services (in part)

- manage the Tree Crop after the establishment phase in accordance with the Management Plan and good silvicultural practice;
- maintain adequate stocking of the plantation by replacing any contiguous area of dead or missing trees in accordance with the Management Plan;
- use all reasonable measures to exterminate and keep the Plantation free of vermin;
- maintain planting mounds by appropriate cultivation and weed control;
- prune the Tree Crop as and when required in accordance with the Management Plan;
- control weeds in accordance with good silviculture practice;
- carry out non-commercial thinning of the Tree Crop as and when required in accordance with the Management Plan;
- establish timber inventory plots and measure the plots regularly;
- use reasonable endeavours to arrange the sale of the Tree Crop; and
- manage the Harvesting in accordance with the Harvesting Plan.

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

52. The Management Services will commence from 1 July 2007 (clause 3.2(b) of the Management Agreement Memorandum).

Pooling of Timber and Grower's entitlement to Net Proceeds

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

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

Fees

54. The following amounts are payable to ITCPM for each Plantation Unit:

- **Establishment Services Fee** of \$4,400 payable on or before the date of execution of the Management Agreement. The Establishment Services for this fee will be completed within 12 months from the date the fee is incurred or from the date the fee is paid, whichever is the earlier (clause 3.2(a) and item 1 of Schedule 3 of the Management Agreement Memorandum);
- **Management Services Fee** equal to 25.74% of the Harvest Proceeds, (defined in clause 1 of the Management Agreement Memorandum) deducted from these proceeds. This fee is for Management Services conducted from 1 July 2007 to the completion of the agreement (clause 3.2(b) and item 2 of Schedule 3 of the Management Agreement);
- **Land Fee** equal to 4.51% of the Harvest Proceeds, deductible from these proceeds. This fee is for the lease of an area of land from the date of the execution of the Land Agreement to the termination date (clause 7 of the Land Agreement and Schedule 2 to the Land Agreement Memorandum);
- **Costs of Harvest and Marketing**, equal to the Grower's proportion of the Harvesting and Marketing costs, which may be deducted from the Proceeds Fund (clause 9 of the Management Agreement Memorandum). This fee is for 'Costs of Harvest and Marketing' as defined in clause 1.1 of the Constitution; and

- **Insurance Premiums** to insure the Grower's tree crop against losses or damage caused by fire or other insurable risk from completion of Establishment Services until the Harvest Commencement Date (the 30th June immediately before the commencement of the clearfell Harvest). These premiums will be paid by ITCPM and recovered from Growers annually. After the Harvest Commencement Date, the premiums will be paid by ITCPM and recovered from harvest proceeds as a Cost of Harvest and Marketing. ITCPM will charge a fee equal to 11% of the gross premium payable by the Grower (including stamp duty and any other charges) to arrange insurance. (clause 10 of the Management Agreement Provisions Memorandum and clause 32 of the Constitution).

Finance

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

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

57. Other than where a Terms Payment Agreement is in place, Growers cannot rely on any part of this Ruling if the Establishment Services Fee is not paid in full on or before 30 June 2007 by the Grower or, on the Grower's behalf, by a lending institution.

Finance options

58. Growers can fund their Establishment Services Fee as follow:

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

- by borrowing from an independent lender.

59. The Terms Payment Agreement offered to Growers by the Responsible Entity will be provided on the following terms.

- Administration Fee of \$275.00 per application, capitalised into the Terms Payment Debt;
- interest free; and
- balance payable by 11 equal monthly instalments.

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

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

3 year reducing balance

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

5 year reducing balance

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

8 year reducing balance

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

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

8 year reducing balance (2 year interest only and 6 year principal and interest

- Minimum deposit of 10%;
- Application Fee of \$250 plus 0.4% of the loan amount, capitalised in the total borrowings;
- 24 monthly instalments of interest then 72 monthly instalments of principal and interest; and
- interest rates will be fixed for the period of the loan and are set on a commercial basis.

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

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

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

66. This Ruling will not apply to Growers who enter into finance arrangements with ITCPM, ITC Finance Pty Ltd or the Nominated Financier, with terms and conditions that differ in any way from those set out in paragraphs 53 to 61 of this Ruling.

67. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- additional benefits' are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than ITC Finance Pty Ltd or the Nominated Financier, are involved or become involved in the provision of finance to Growers for the Project.

Commissioner of Taxation

28 February 2007

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 paragraph 23 of this Ruling to constitute allowable deductions the Growers afforestation activity must amount to the carrying on of a business of primary production.

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

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

71. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the ITC Pulpwood Project 2007. As TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

72. Having applied these principles to the arrangement set out above, a Grower in the ITC Pulpwood Project 2007 is accepted to be carrying on a business of growing and harvesting timber for sale.

The Simplified Tax System

Division 328

73. 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.

74. Changes to the STS rules apply from 1 July 2005. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Establishment Services Fees

Section 8-1

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

76. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Subject to the prepayment provisions (see paragraphs 77 to 81 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

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

78. Other than where the prepayment provisions apply (see paragraphs 83 to 84 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Terms Payment Administration Fee

Section 40-880

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

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

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

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

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

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

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

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

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

Section 82KZMG

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

87. Under the Management Agreement, a Grower incurs an Establishment Services Fee consisting of expenditure of \$4,400 per Plantation Unit for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the trees.

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

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

89. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the 2006-07 income year who carries on a business of afforestation individually (alone or in partnership) is expected to incur losses from their participation in the Project for each of the income years from 2006-07 to 2021-22 which will be subject to Division 35.¹ These losses will be subject to the loss deferral rule in section 35-10 unless an exception applies or, for each income year in which losses are incurred, the Commissioner exercises the discretion in subsection 35-55(1) on 30 June of that specific income year.

90. The exceptions to the loss deferral rule depend upon the circumstances of individual Growers and are outside the scope of this Product Ruling.

¹ Division 35 does not apply to Growers who do not carry on a business or who carry on a business other than as individuals (alone or in partnership).

91. The Commissioner will apply the principles set out in Taxation Ruling TR 2007/6 Income tax: non commercial business losses: Commissioner's discretion when exercising the discretion.

91A. For the 2006-07 to 2016-17 income years, a Grower who incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the Scheme described in the Ruling, and the discretion in paragraph 35-55(1)(b) as it applied is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will satisfy one of the four tests set out in Division 35 or produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)).

91B. In the 2009-10 income year an income requirement was introduced to Division 35. This income requirement will apply to Growers in the Project from the 2017-18 to 2021-22 income years. Where a Grower with income for NCL purposes of less than \$250,000 (that is, the Grower satisfies the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the Scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(b) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will satisfy one of the four tests set out in Division 35 or produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)).

91C. For the 2017-18 to 2021-22 income years, where a Grower with income for NCL purposes of \$250,000 or more (that is, the Grower does not satisfy the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(c) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not produce assessable income greater than the deductions attributable to it; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)).

91D. A Grower will satisfy the income requirement in subsection 35-10(2E) where the sum of the following amounts is less than \$250,000:

- taxable income for that year (ignoring any loss arising from participation in the Project or any other business activity);
- total reportable fringe benefits for that year;
- reportable superannuation contributions for that year; and
- total net investment losses for that year.

91E. In each individual year where the Commissioner's discretion is exercised a Grower within either paragraph 91A, paragraph 91B or paragraph 91C of this Ruling who would otherwise be required to defer a loss arising from their participation in the Project under section 35-10 until a later income year is able to offset that loss against their other assessable income.

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Section 82KL – recouped expenditure

92. The operation of section 82KL of the ITAA 1936 depends. Among other things, on the identification of a certain quantum of 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

93. 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).

94. The ITC Pulpwood Project 2007 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 23 of this Ruling that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

95. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the wood produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8; TR 2002/6;
TR 2002/11; TR 2007/6;
TD 2003/12

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME

- ITAA 1936 82KZMF
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- ITAA 1936 Pt IVA
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- ITAA 1997 Div 35
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