


PR 2007/72 - Income tax: ITC Diversified Forestry Project 2007 (Stage 2)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *25 July 2007*



Product Ruling

Income tax: ITC Diversified Forestry Project 2007 (Stage 2)

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

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

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

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

No guarantee of commercial success

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

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

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

Terms of use of this Product Ruling

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

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the ITC Diversified Forestry Project 2007 (Stage 2) 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.

3. The class of entities who can rely on those tax benefits are referred to as Growers. Growers will be those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and who have executed the relevant Project Agreements set out in paragraph 26 of this Ruling on or before 30 June 2008.

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:

- do not intend to derive assessable income from their involvement in the scheme;
- are accepted into this Project before the date of this Ruling or after 30 June 2008;
- 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 arrangements specified in paragraphs 61 to 71 of this Ruling;
- have not paid the Establishment Services Fee by 30 June 2008, where they have not entered into a finance arrangement as detailed in paragraphs 61 to 71 of this Ruling; 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 2008 or the finance has been approved but the funds have not been made available to ITC Project Management Limited ('the Responsible Entity') by 31 July 2008.

Superannuation Industry (Supervision) Act 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment may contravene the provisions of SISA 1993.

Qualifications

6. 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 72 of this Ruling.

7. 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

9. This Product Ruling applies prospectively from 25 July 2007, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 25 July 2007 until 30 June 2008, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2010.

10. 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.

11. 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).

12. 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.

13. 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

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

15. 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

16. 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

17. 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**

18. 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 72 of this Ruling.

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

Small business concessions

20. From the 2007-08 income year, a range of concessions previously available under the STS, will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

21. A small business entity can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Accordingly application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

Assessable income**Sections 6-5 and 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.

Deduction for Establishment Services Fee and other costs**Section 8-1, section 25-25, Division 27 and section 40-880 of the ITAA 1997 and section 82KZMG of the Income Tax Assessment Act 1936**

23. A Grower may claim tax deductions for the following fees and expenses on a per Diversified Forestry Unit basis, as set out in the Table below.

Fee Type	Year ending 30 June 2008	Year ending 30 June 2009	Year ending 30 June 2010
Establishment Services Fee	\$5,500 See Notes (i) and (ii)	Nil	Nil
Credit card Merchant Service Fee	As incurred See Notes (i) and (iii)	As incurred See Notes (i) and (iii)	As incurred See Notes (i) and (iii)
Terms Payment Administration Fee	Must be calculated See Notes (i) and (iv)	Must be calculated See Notes (i) and (iv)	Must be calculated See Notes (i) and (iv)
Insurance Costs	As incurred See Notes (i) and (iii)	As incurred See Notes (i) and (iii)	As incurred See Notes (i) and (iii)
Application fee for loans with ITC Finance Pty Ltd or the Preferred Financier	Must be calculated See Notes (i) and (v)	Must be calculated See Notes (i) and (v)	Must be calculated See Notes (i) and (v)
Interest on loans with ITC Finance Pty Ltd or the Preferred Financier	As incurred See Note (vi)	As incurred See Note (vi)	As incurred See Note (vi)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the Establishment Services Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 92 to 94 of this Ruling) and is deductible in the income year in which it is incurred.

- (iii) The credit card merchant fees, the Insurance Costs paid by the Grower to the Responsible Entity and Interest on loans with ITC Finance Pty Ltd or the Preferred Financier are deductible under section 8-1 in the income year that the relevant amount is incurred.
- (iv) The terms payment administration fee of \$275 payable to the Responsible Entity 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 84 and 85 of this Ruling).
- (v) The loan application fee of \$250 plus 0.4% of the loan amount, payable to ITC Finance Pty Ltd or the Preferred Financier is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing money that is used or is 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 Preferred Financier is outside the scope of this Ruling.
- (vi) The deductibility or otherwise of interest arising from agreements entered into with financiers other than ITC Finance Pty Ltd or the Preferred Financier, is outside the scope of this Ruling. Prepayments of interest to any lender, including ITC Finance Pty Ltd Finance and the Preferred Financier, are also not covered by this Product Ruling. Growers who enter into agreements with other financiers and/or prepay interest may request a private ruling on the deductibility of the interest incurred.

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

Section 35-55 – exercise of Commissioner’s discretion

24. A Grower who is an individual accepted into the Project in the year ended 30 June 2008 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 below, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for Growers for the income years ended **30 June 2008 to 30 June 2028**. This conditional exercise of the discretion will allow those losses to be offset against the Grower’s other assessable income in the income year in which the losses arise.

Prepayment provisions and anti-avoidance provisions

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

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

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

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 28 August 2006 and additional correspondence, including emails, received 22 May 2007, 23 May 2007, 14 June 2007, and 4 July 2007;
- Draft **Product Disclosure Statement** for the ITC Diversified Forestry Project 2007 (Stage 2) received on 23 May 2007;
- Draft Scheme Constitution made by ITC Project Management Ltd establishing the ITC Diversified Forestry Project 2007 (Stage 2) received on 14 June 2007;
- Draft Compliance Plan for ITC Project Management Ltd received 28 August 2006;
- Draft **Land Agreement** between ITC Project Management Ltd and the Grower received 28 August 2006;
- Draft **Memorandum (Land Agreement Provisions)** for the ITC Diversified Forestry Project Stage 2 received 28 August 2006;
- Draft **Agreement to enter Land Agreement** between ITC Project Management Ltd and the Grower received 28 August 2006;

- Draft **Management Agreement** between ITC Project Management Ltd and the Grower received 28 August 2006;
- Draft **Memorandum (Management Agreement Provisions)** for the ITC Diversified Forestry Project Stage 2 received 28 August 2006;
- Draft **Tree Farm Loan Application** and **Tree Farm Loan Deed** for the ITC Diversified Forestry Project Stage 2 received 28 August 2006;
- Draft Deed (Tree Farm Loan) between ITC Finance Pty Ltd and Elders Rural Bank Ltd received 28 August 2006;
- Draft Forestry Management Agreement for Diversified Forestry Project Stage 1 and 2 between Integrated Tree Cropping Ltd and ITC Project Management Ltd received 28 August 2006;
- Draft Service Agreement dated 30 June 2003 between Australian Plantation Timber Ltd and Integrated Tree Cropping Ltd received 28 August 2006;
- Draft Treefarm Management Plan for the ITC Diversified Forestry Project Stage 2 received 28 August 2006; and
- Memorandum of Association dated 12 February 1998 for ITC Project Management Ltd received 28 August 2006.

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

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

28. 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. The effect of these agreements is summarised as follows.

29. The main features of the ITC Diversified Forestry Project 2007 (Stage 2) are as follows:

Type of business to be carried on by each Grower	Commercial growing and cultivation of differing species of trees for the purpose of harvesting and selling of timber or timber produce.
Term of the Project	20 years
Number of hectares offered for cultivation	Approximately 10,000 hectares
Size of each Diversified Forestry Unit	Approximately 1 hectare
Minimum allocation per Grower	2 Diversified Forestry Units
Minimum subscription	nil
Initial cost	\$11,000
Insurance Costs before clearfall	Insurance arrangement fee Annual premiums
Other possible costs	Credit Card Merchant Service Fee Terms Payment Administration Fee Loan Application Fee and Stamp Duty Interest Reimburse the Responsible Entity for fees, charges, duties, etc
Deferred costs payable from Harvest Proceeds	Management Services Fee – 34.1% of Harvest Proceeds Land Fee – 11.55% of Harvest Proceeds Harvest and Marketing costs Insurance after clearfall

30. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. ITC Project Management Pty Ltd has been issued with an Australian Financial Service Licence (Licence number 247019) and will be the Responsible Entity for the Project.

31. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for approximately 10,000 hectares, which corresponds to approximately 10,000 Diversified Forestry Units in the Project. Oversubscriptions may be accepted where suitable land can be located.

32. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to enter into, on behalf of the Grower, a Land Agreement, a Management Agreement and any other documents required to hold an interest in the Project.

33. The Project will involve establishing, cultivating, maintaining, and harvesting timber of different species and in multiple locations across mainland Australia. The Responsible Entity has secured 7,142 plantable hectares which may be used in the Project, and has made offers for a further 4,522 plantable hectares. Land utilised by the Project must meet the requirements set out by the Independent Forester at pages 59 through 69 of the PDS.

34. An entity that participates in the Project will do so by acquiring an interest in the Project on or before 30 June 2008, which will consist of a minimum of 2 Diversified Forestry Units.

35. Each Diversified Forestry Unit will comprise four woodlots of differing species planted in differing locations, with an area planted of approximately 1 hectare per unit. The actual woodlot sizes vary depending on the anticipated productivity of the specific land. In order to meet the yields defined in clause 1.1 of the Constitution the size of the woodlots are fixed prior to the allocation of the Diversified Forestry Units to the Growers. Once allocated to a Grower the woodlots will not be further adjusted.

36. The species to be planted for each woodlot are set out in the PDS and Constitution, being approximately:

- 0.75 hectare of Pulpwood being Tasmanian Blue gum (*Eucalyptus globulus*), Rose gum (*Eucalyptus grandis*), Rose and River gum hybrid (*Eucalyptus grandis* x *Eucalyptus camaldulensis*), Spotted gum (*Corymbia citriodora* subsp *variegata*), or Dunn's white gum (*Eucalyptus dunnii*);
- 0.1 hectare of Red Mahogany (*Eucalyptus pellita*);
- 0.05 hectare of Indian Sandalwood (*Santalum album*); and
- 0.1 hectare of Teak (*Tectona grandis*).

37. Each Grower will use their woodlots for the purpose of carrying on a business of cultivating and harvesting pulpwood, red mahogany, teak, and sandalwood and the sale of harvested produce.

38. To participate in the Project, Growers must pay the Establishment Services Fee and other costs as required under the Project agreements. The Management Services Fee and Land Management Fee will be deducted from any amounts payable to the Grower from the Project Harvest Proceeds.

39. The trees are expected to be harvested from approximately 7 to 20 years after planting, depending on the species, and the Responsible Entity will arrange the harvest and sale of the timber.

Constitution

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

41. In order to acquire an interest in the Project, the Grower must make an application for Diversified Forestry Units in accordance with clause 4. The application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the applicant, lodged at the office of the Responsible Entity and accompanied by payment of the appropriate application price or instalment in a form acceptable to the Responsible Entity.

42. Under clause 5.1 of the Constitution, the Responsible Entity holds the application moneys on bare trust in a special trust account.

Compliance Plan

43. As required by the Corporations Act, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan 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.

Land Agreement and Memorandum (Land Agreement Provisions)

44. The Responsible Entity will enter into a Land Agreement with the Grower, which identifies the location and size of the Growers woodlots, and binds the parties to follow the Memorandum (Land Agreement Provisions) document.

45. The Memorandum sets out the rights, obligations, and covenants of the Grower and Responsible Entity, which include:

- (subject to the appointment of the Responsible Entity to conduct the actual activities under the Management Agreement), the Grower has the right to harvest the tree crop and sell the products (clause 3);
- the Grower shall not use the woodlots for any purpose other than growing and harvesting trees (clause 4(a));
- the Responsible Entity agrees to make reasonable quantities of water available for irrigation on the Sandalwood woodlots (clause 5(e));
- the Grower must pay the Land Fee to the Responsible Entity (clause 7); and

- the termination dates of the woodlots are set out in Schedule 1.

Agreement to enter Land Agreement

46. Where there is no Project land available for a Grower, the Grower and the Responsible Entity can enter into the Agreement to enter into Land Agreement, whereby a Land Agreement will be entered into as soon as land becomes available.

47. Under the agreement, the subsequent Land Agreement must be executed on or before the Last Day, which is defined as the earlier of:

- 9 months after the date of the Agreement to enter Land Agreement; or
- the latest date that the Responsible Entity considers will allow sufficient time to complete the Establishment Services within 12 months after the Grower incurred the Establishment Services Fee.

Management Agreement and Memorandum (Management Agreement Provisions)

48. Under the Management Agreement the Grower appoints the Responsible Entity to procure trees, carry out plantation services, and to perform services subject to the terms and conditions of the agreement and the Memorandum. The Management Agreement will commence on the date the Responsible Entity executes the Management Agreement, and shall continue until termination under item 3 of Schedule 1 of the Memorandum.

49. The Responsible Entity will commence the provision of the Establishment Services and Management Services from the date the Grower enters into the Project.

50. The Establishment Services are detailed in Schedule 2 of the Memorandum, being:

- procure sufficient trees to the recommended specifications;
- prepare land for planting;
- plant trees, and in the case of Sandalwood, plant host trees; and
- supervise and secure management of the Establishment Services.

51. The Establishment Services will be completed within the earlier of:

- 12 months after the date the liability for the Establishment Services fee is incurred by the Grower; or
- 12 months after the Grower pays the Establishment Services fee.

52. The Management Services are detailed at Schedule 2 of the Memorandum, and include:

- manage the tree crop after the establishment phase;
- maintain adequate stocking of the plantation and replace dead or missing trees;
- prune the tree crop;
- monitor nutrient status and apply fertiliser;
- carry out non-commercial thinning;
- prepare annual report on the state of the tree crop;
- arrange the sale of the tree crop and enter into a sale agreement as agent for the Grower pursuant to which the proceeds will be paid to the Responsible Entity;
- prepare a harvesting plan and manage the commercial thinning and clearfall harvest;
- select and engage contractors to carry out the harvest; and
- effect insurance, at the Growers cost.

Pooling of Timber and Grower's Entitlement to Net Proceeds

53. The Responsible Entity shall collect the proceeds from the sale of timber and other Project income, and to pay them into a Proceeds Fund (clauses 3.3(a) and 30.1 of the Constitution).

54. The Responsible Entity is authorised to deduct a number of expenses from the Proceeds Fund, including the costs of harvest and marketing, reimbursement of expenses, taxes, etc (clauses 30.2, 32.1, and 32.2 of the Constitution, and clause 10.2 of the Memorandum (Management Agreement Provisions)).

55. Clause 31 of the Constitution outlines the process for the payment of profit to Growers from the Proceeds Fund.

56. Clause 8 of the Memorandum (Land Agreement Provisions) and clause 10.1(d) of the Memorandum (Management Agreement Provisions) set out the Grower's entitlement to insurance proceeds in the event of a fire or other insured event affecting a Growers woodlot.

57. This Product Ruling only applies where the following principles apply to pooling and distribution arrangements:

- only Growers who have contributed to the Proceeds Fund are entitled to distributions of proceeds from the pool; and
- Any pooled proceeds must consist only of wood produce contributed by Growers from this Project.

Fees

58. The amounts payable under the various Project agreements are summarised below.

Fees payable under the Management Agreement and Memorandum (Management Agreement Provisions)

59. Clauses 5, 9, 10 and Schedule 3 of the Memorandum (Management Agreement Provisions) provide that the Grower will pay the Responsible Entity the following amounts, per Diversified Forestry Unit:

- **Establishment Services Fee** of \$5,500 payable on or before the date of execution of the Management Agreement;
- **Management Services Fee** calculated as 34.1% of the Harvest Proceeds, payable each time an instalment of Harvest Proceeds is distributed to the Grower;
- **Insurance Cost** up to clearfall – each Grower to pay a proportional share of **insurance** and the **insurance administration fee**, payable without demand or as notified in writing;
- **Costs of harvesting and marketing** which may be deducted from the Proceeds Fund; and
- **Insurance** after clearfall, to be deducted from the Proceeds Fund.

Fees payable under the Land Agreement and Memorandum (Land Agreement Provisions)

60. Clause 7 and Schedule 2 of the Memorandum (Land Agreement Provisions) provide that the Grower must pay an amount of Land Fee to the Responsible Entity, and that the amount of the fee is 11.55% of the Harvest Proceeds, payable each time that an instalment of Harvest Proceeds is payable to the Grower.

Finance

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

62. 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 Preferred Financier that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than the Preferred Financier may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

63. 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 2008 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted subject to finance approval by any lending institution other than ITC Finance Pty Ltd, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2008.

Terms Agreement

64. The Responsible Entity offers an interest free terms payment for part of the Establishment Services Fee, under the Terms Payment Agreement which forms part of the PDS.

65. Where the Responsible Entity accepts an application from a Grower to pay the Establishment Services Fee under a Terms Payment Agreement, a Terms Payment Deposit of 10% of the Establishment Services Fee must be paid by 15 June 2008 for applications received before that date.

66. The balance of the Establishment Services Fee and the \$275 Terms Payment Administration Fee are payable by direct debit in 11 equal instalments on the last day of the month from 31 July 2008 to 31 May 2008.

67. If a Grower defaults on payments, then interest of 14.95% compounded monthly will apply to amounts overdue and the Grower will also be liable for other unspecified legal fees and costs.

Finance offered by ITC Finance Pty Ltd or the Preferred Financier

68. A Grower can obtain long term finance for part of their Establishment Services Fees from either ITC Finance Pty Ltd or the Preferred Financier.

69. Both lenders use the same package of documents with the title 'Tree Farm Loan'. The package contains a loan application, schedule, and deed.

70. Subject to acceptance of the loan application, the Grower will be bound by the terms and conditions of the Tree Farm Loan Deed.

71. The loan terms and conditions include:

- the maximum loan amount is 90% of the Establishment Services Fee per Diversified Forestry Unit;
- the loan amount must be at least \$15,000;
- the Grower incurs a loan application fee of \$250 plus 0.4% of the loan amount, which is added to the total amount borrowed;
- the minimum term of the loan is 3 years;
- the term options require the repayment of the principal plus interest by monthly (direct debit) instalments over 3, 5 or 10 year periods;
- from the Preferred Financier only, there is a 10 year loan option whereby interest only is paid for the first 3 years, and then principal plus interest for the remaining 7 years;
- the interest rates for the loans will be fixed for the period of the loan and are set on a commercial basis; and
- the loan can only be used to pay the Establishment Services Fees for the Project, and will be paid by the lender directly to the Responsible Entity by no later than 31 July 2008.

72. 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.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;

- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than the Responsible Entity, ITC Finance Pty Ltd or the Preferred Financier, are involved or become involved in the provision of finance to Growers for the Project.

Fees if paying by credit card

74. Where the Applicant/Grower makes a payment or remittance using a credit card, page A-5 of the Application Form authorises the Responsible Entity to debit the Applicant's/Grower's credit card for the amount being paid plus a 1.1% Merchant Service Fee.

Commissioner of Taxation

25 July 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?

75. For the amounts set out in paragraph 23 of this Ruling to constitute allowable deductions the Grower's afforestation activities as a participant in the ITC Diversified Forestry Project 2007 (Stage 2) must amount to the carrying on of a business of primary production.

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

77. 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?

78. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the ITC Diversified Forestry Project 2007 (Stage 2). As Taxation Ruling 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.

79. Having applied these principles to the arrangement set out above, a Grower in the ITC Diversified Forestry Project 2007 (Stage 2) is accepted to be carrying on a business of growing and harvesting timber for sale.

Deductibility of the Establishment Services Fee, Insurance Costs, credit card merchant fee, and interest on loans with ITC Finance Pty Ltd or the Preferred Financier

Section 8-1

80. 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 (see paragraphs 49 to 51 of TR 2000/8).

81. 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 86 to 91 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.)

82. Some Growers may finance their participation in the Project through a Loan Agreement with ITC Finance Pty Ltd or the Preferred 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.

83. Other than where the prepayment provisions apply (see paragraphs 86 to 94 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Deductibility of the Terms Payment Administration Fee

Section 40-880

84. 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.

85. However, section 40-880 will allow the Terms Payment 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

86. 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.

87. 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 of the ITAA 1936 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***

88. Other than the Establishment Services Fee (see below), the fees payable under the scheme to which this Product Ruling applies are payable:

- as incurred and in the year incurred (Insurance Costs, interest on unpaid fees, legal and other costs, payable to the Responsible Entity;
- monthly in arrears (interest and finance costs on long term loans payable to ITC Finance Pty Ltd or the Preferred Financier; or
- out of harvest proceeds (Land and Management Fees, costs of harvest and marketing, insurance after clearfall, payable to the Responsible Entity.

89. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to expenditure incurred by Growers under this scheme.

90. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays interest under a loan agreement.

91. 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

92. 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.

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

94. 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 2008 for the full amount of expenditure incurred by the Grower for the Establishment Services Fee.

Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion

95. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2008 to 30 June 2028**, based on the evidence supplied, the Commissioner has determined that for those income years:

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

96. 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.

97. 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

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

Part IVA – general tax avoidance provisions

99. 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).

100. The ITC Diversified Forestry Project (Stage 2) 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.

101. 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 timber or 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:

Previous Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8; 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
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- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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- ITAA 1936 82KZMG
- ITAA 1936 Pt IVA
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- ITAA 1997 Div 27
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- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
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- ITAA 1997 40-880
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
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Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

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