



# ***PR 2008/14 - Income tax: Capricorn Timber Indian Sandalwood Project***

 This cover sheet is provided for information only. It does not form part of *PR 2008/14 - Income tax: Capricorn Timber Indian Sandalwood Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *20 February 2008*



## Product Ruling

### Income tax: Capricorn Timber Indian Sandalwood Project

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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 provisions identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. Unless otherwise indicated, all legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997). In this Product Ruling the scheme is referred to as the Capricorn Timber Indian Sandalwood Project or simply as 'the Project'.

### Class of entities

2. This part of the Product Ruling specifies which entities;

- are subject to the taxation obligations; and
- can rely on the taxation benefits,

set out in the Ruling section of this Product Ruling.

3. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to as Growers.

4. Growers will be those entities that are accepted to participate in the scheme specified below as initial participants<sup>1</sup> on or after the date this Product Ruling is made. They will have executed the relevant Project Agreements set out in paragraph 35 of this Ruling on or before 30 June 2008.

5. 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:

- participate in the scheme other than as initial participants;
- 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 (PDS);
- enter into finance arrangements with entities associated with this Project, other than those specified in paragraph 94 of this Ruling;
- have not paid the Establishment Fee by 30 June 2008, where they have not entered into a finance arrangement; or

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<sup>1</sup> For the purposes of this Product Ruling an 'initial participant' means a participant who has obtained their interest in the scheme from the Responsible Entity or the Manager of the scheme.

- have their application conditionally accepted subject to finance by a lending institution for the payment of the Establishment Fee, where the finance has been approved but the funds have not been made available to the Responsible Entity by 30 June 2008.

**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 35 to 100 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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**Superannuation Industry (Supervision) Act 1993**

9. 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 in this product may contravene the provisions of SISA 1993.

## Date of effect

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10. This Product Ruling applies prospectively from 20 February 2008, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 20 February 2008 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.

11. 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.

12. 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)).

13. 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.

14. 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

15. 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.

16. 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**

17. 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**

18. 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**

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**Application of this Ruling**

19. 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 below at paragraphs 35 to 100 of this Ruling.

20. 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 Licence and Management Agreement.

**Minimum subscription**

21. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. A Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 275 Woodlots is achieved.

**Concessions for 'small business entities'<sup>2</sup>**

22. From the 2007-08 income year, a range of concessions previously available under the simplified tax system (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').

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<sup>2</sup> The meaning of 'small business entity' is explained in section 328-110.

23. 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. Because of these choices and the eligibility conditions the 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.

### **Deductions for the Establishment Fee**

#### ***Section 8-1 and Division 27 of the ITAA 1997 and section 82KZMG of the Income Tax Assessment Act 1936***

24. Other than where a 'CGT event'<sup>3</sup> happens to their interest within 4 years of 30 June 2008 (see paragraph 25 of this Ruling), a Grower who is an initial participant in the scheme may claim tax deductions for the following amount on a per Woodlot basis.

<b>Fee Type</b>	<b>Year ending 30 June 2008</b>	<b>Year ending 30 June 2009</b>	<b>Year ending 30 June 2010</b>
<b>Establishment Fee</b>	\$16,000 See Notes (i) & (ii)	Nil	Nil

#### **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 Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 115 to 120 of this Ruling) and is deductible in the income year in which it is incurred.

### **'CGT event' within 4 years for Growers who are 'initial participants'**

#### ***Section 82KZMGA***

25. A deduction for the Establishment Fee is not allowable where a 'CGT event' happens in relation to a Grower's interest before 1 July 2012 (subsection 82KZMGA(1) of the ITAA 1936).

26. Where deductions for these amounts have already been claimed by a Grower the Commissioner may amend their assessment at any time within two years after the end of the income year in which the 'CGT event' happens. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 82KZMGA(2) of the ITAA 1936).

<sup>3</sup> Defined in section 995-1.

27. Growers whose deductions are disallowed are still required to include in their assessable income the market value of the interest at the time of the 'CGT event' or the decrease in the market value of the interest as a result of the 'CGT event' (see paragraphs 121 to 123 of this Ruling).

**Deductions for loan interest, borrowing costs, ongoing management fees and occupation fees**

***Sections 8-1, 25-25 and 40-880 and Division 27***

28. A Grower who is an initial participant in the scheme may also claim tax deductions for the following fees and expenses on a per Woodlot basis, as set out in the Table below.

<b>Fee Type</b>	<b>Year ending 30 June 2008</b>	<b>Year ending 30 June 2009</b>	<b>Year ending 30 June 2010</b>
<b>Interest on loans with United Pacific Finance Pty Ltd</b>	Nil	As incurred See Note (iii)	As incurred See Note (iii)
<b>Loan Establishment Fee</b>	Must be calculated See Note (iv)	Must be calculated See Note (iv)	Must be calculated See Note (iv)
<b>Ongoing Management Fee</b>	Nil	Nil	\$1,650
<b>Occupation Fee</b>	Nil	Nil	\$412.50

**Notes:**

- (iii) Interest on loans with United Pacific Finance Pty Ltd (the Preferred Financier) is deductible in the year in which it is incurred (section 8-1). The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Preferred Financier, is outside the scope of this Ruling. Prepayments of interest to any lender, including 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 (see paragraph 114 of this Ruling).
- (iv) The Loan Establishment Fee payable to the Preferred Financier is a borrowing expense and is deductible under section 25-25. The deduction for the borrowing expense is spread over 5 years on a straight line basis from the date the loan begins.



- (v) The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than the Preferred Financier is outside the scope of this Ruling.

## **Assessable income from 'CGT events' for Growers who are initial participants**

### ***Sections 6-10, 17-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936***

29. Where a 'CGT event' happens to the interest held by a Grower who is an initial participant in this Project, the market value of the interest, or the decrease in the market value of the interest, is included in the Grower's assessable income (section 6-10 of the ITAA 1997 and section 82KZMGB of the ITAA 1936), less any GST payable on those proceeds (section 17-5 of the ITAA 1997).

30. The amount is included in the Grower's assessable income in the income year in which the 'CGT event' happens (subsection 82KZMGB(2) of the ITAA 1936).

31. 'CGT events' for these purposes include those relating to:

- a **clear-fell harvest of all or part of the trees** grown on the Grower's Woodlot(s);
- the **sale, or any other disposal** of all or part of the 'interest' in the Project held by the Grower; or
- any other 'CGT event' that results in a reduction of the market value of the 'interest' in the Project held by the Grower.

32. Where an amount arising from a 'CGT event' is included in the assessable income of a Grower by section 82KZMGB of the ITAA 1936 the anti-overlap provisions in section 118-20 of the ITAA 1997 will operate to exclude that amount from the capital gains provisions in Part 3-1 of the ITAA 1997.

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

### ***Section 35-55 – exercise of Commissioner's discretion***

33. 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 2023**. 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***

34. For a Grower who commences participation in the Project and incurs expenditure as required by the Constitution and the Licence 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.

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**Scheme**

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

- Application for a Product Ruling as constituted by documents and information provided on 29 August 2007, 12 September 2007, 2, 5, 8, 26 and 27 November 2007, 3, 8 and 31 January 2008; 4, 5, 11 and 12 February 2008;
- Draft Product Disclosure Statement (PDS) for the Capricorn Timber Indian Sandalwood Project received on 27 November 2007;
- Draft **Constitution** establishing the Capricorn Timber Indian Sandalwood Project received on 27 November 2007;
- Draft Compliance Plan for the Capricorn Timber Indian Sandalwood Project received 29 August 2007;
- Draft Lease agreement between Capricorn Land Holdings Pty Ltd as Head Lessor and Huntley Management Limited as Lessee received 27 November 2007;
- Draft **Licence and Management Agreement** forming Schedule 1 to the Draft Constitution, to be entered into by each Grower and Huntley Management Limited received 27 November 2007;

- Draft Operational Management Agreement, to be entered into by Huntley Management Ltd and Capricorn Timber Plantations Pty Ltd, received 27 November 2007;
- Draft Operations Agreement, to be entered into by Capricorn Timber Plantations Pty Ltd and Capricorn Timber Management Pty Ltd, received 27 November 2007; and
- Draft **Finance Application** incorporating Loan Application, Conditions, and **Offer to Borrow**, to be entered into by a Grower and the Preferred Financier, received 8 January 2008.

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

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

37. 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.

38. The main features of the Capricorn Timber Indian Sandalwood Project are as follows:

Location	Kununurra, Western Australia
Type of business to be carried on by each Grower	Cultivation, harvest and sale of Indian Sandalwood
Term of the Project	15 years
Number of hectares offered for cultivation	200
Size of each Woodlot	0.25 hectares
Minimum allocation per Grower	One Woodlot
Minimum subscription	275 Woodlots
Initial cost	\$16,000
Ongoing costs	<ul style="list-style-type: none"> <li>• Ongoing Management Fees and</li> <li>• Occupation Fees</li> </ul>
Other costs	<ul style="list-style-type: none"> <li>• Harvest Fees and Marketing and Sales Fees payable out of Product Sale Proceeds and</li> <li>• crop insurance at the discretion of the Responsible Entity</li> </ul>

39. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Huntley Management Limited has been issued with an Australian Financial Service Licence number 229754 and will be the Responsible Entity for the Project.

40. The Project will involve the cultivation, harvest and sale of Indian Sandalwood. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 200 hectares, which corresponds to 800 Woodlots in the Project of 0.25 hectares in size.

41. An entity that participates in the Project will do so by acquiring the minimum interest in the Project of one Woodlot on or before 30 June 2008.

42. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity and each of its directors or company secretary as the Grower's attorney to execute, on behalf of the Grower, the Licence and Management Agreement and any other documents required to hold an interest in the Project.

43. Under the terms of the Constitution, the Project will commence when the minimum subscription of 275 Woodlots is reached.

44. The Responsible Entity will lease land for the Project within the Kununurra region of Western Australia. Land utilised by the Project must meet the requirements set out in the Independent Forester's report, which is included in the PDS. The land is described as Lot 605 Mulligan's Lagoon Road, Kununurra, being Lot 605 on Deposited Plan 215941, being the land in Certificate of Title Volume 2170 Folio 778.

45. This Land will be divided into Woodlots and licensed to the Growers accepted into the Project.

46. Each Grower will use their Woodlot/s for the purpose of carrying on a business of cultivating and harvesting Indian Sandalwood trees and the sale of harvested produce. Harvest is expected to take place from year 14.

47. Thinning of the trees will be carried out by the Responsible Entity, but there will be no sales from thinning.

### **Constitution**

48. The Constitution establishes the Project and operates as a contract binding all Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Huntley Management Ltd agrees to act as Responsible Entity and manage the Project. Upon acceptance into the Project, by entering into the Licence and Management Agreement, Growers are bound by the Constitution. Terms defined in the Project's agreements appear in this Ruling in capital letters.

49. In order to acquire an interest in the Project, the Grower must make an application for Woodlots in accordance with clause 15. Among other things, the application is to be completed in a form approved by the Responsible Entity, signed by the Applicant, lodged at the address nominated on the Application Form and accompanied by payment of the Application Money (which comprises the Establishment Fee) in a form acceptable to the Responsible Entity.

50. Under clause 15.1 of the Constitution, all moneys received from applications will be paid into the Applications Bank Account.

51. Once certain specified criteria in the Constitution have been met and the Responsible Entity has accepted the application, the Responsible Entity must transfer the relevant application moneys into the Scheme Bank Account (subclauses 15.1, 15.3 and 15.7).

52. In summary, the Constitution also sets out provisions relating to:

- Complaints handling (clause 6);
- Winding up the Project (clause 7);
- Register of Growers (clause 17);
- Distribution of Proceeds (clause 18); and
- Retirement and removal of the Responsible Entity (clause 23).

## **Compliance Plan**

53. As required by the *Corporations Act 2001*, 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.

## **Lease**

54. The Responsible Entity will enter into a Lease with Capricorn Land Holdings Pty Ltd in respect of land required for the Project.

55. Under the Lease, the Responsible Entity must use the land only in accordance with the Constitution, the Compliance Plan and the Licence and Management Agreement (clause 6).

56. The Responsible Entity may also licence the land to Growers for the purposes of the Project (clause 10.2).

## **Licence and Management Agreement**

57. Each Grower will enter into a Licence and Management Agreement with the Responsible Entity.

***Licence***

58. Under the Licence and Management Agreement, the Responsible Entity will grant to the Grower a Licence of the Woodlot. The Licence gives the Grower the exclusive right to carry out the Grower's Business upon the Woodlot and to do all other things that may be necessary to be carried out upon the Woodlot pursuant to the Licence and Management Agreement and the Constitution (clause 3.1).

59. The term of the Licence is for the same term as the Grower's Business of cultivation of Indian Sandalwood trees, and the harvesting, marketing and sale of the wood (clause 3.4).

60. Under the Licence, the Grower has the right of ingress and egress to and from the Woodlot and the use of any common parts of the Land at all reasonable times as are necessary for the Grower to conduct the Grower's Business (clause 3.5).

61. The Grower will pay the Responsible Entity Occupation Fees for the licence of the Woodlot, commencing in the 2010 income year (clause 4).

62. The Grower's obligations under the Licence and Management Agreement are set out in detail in clause 10, under which the Grower agrees, among other things, not to use the Land except for the purpose of the Grower's Business.

***Management of the Grower's Business***

63. Under clause 2.1 of the Licence and Management Agreement, the Grower appoints the Responsible Entity as the manager of the Grower's Business to carry out for the Grower:

- the Establishment Services;
- the Ongoing Management Services;
- the Harvest Services; and
- the Marketing and Sales Services

and to do all things as may be necessary for the Grower to carry out the Grower's Business.

64. Under clause 6, the Grower is obliged to pay to the Responsible Entity the Establishment Fee, Ongoing Management Fees, Occupation Fees, Harvest Fees and Marketing and Sales Fees, together with GST at the prevailing rate.

65. The Licence and Management Agreement will commence on the Settlement Date (and in any case no later than 30 June 2008) and continue until its termination on 30 June 2023 or the date on which the Grower's Business Income is distributed to the Grower (clause 2.3). The Settlement Date is defined as the day the Responsible Entity has accepted the Application Form signed by the Grower and received all funds.

66. The Establishment Services will be performed during the Initial Period, which is defined as the 12 month period commencing on 1 July 2008 (clause 5.1).

67. The Establishment Services are defined as services which are seasonally dependent agronomic activities as defined in section 82KZMG of the ITAA 1936, and include:

- ploughing, ripping and other soil preparation works;
- procurement of seedlings;
- tending seedlings prior to planting;
- planting seedlings;
- applying fertilised, herbicide or pesticide in conjunction with planting of the seedlings;
- vegetation and other pest reduction and eradication activities to the extent that they are part of the establishment of the Grower's timber plantation on the Woodlot;
- procurement and delivery of necessary supplies and materials for these activities and supervision of the activity.

68. The Responsible Entity will carry out the Ongoing Management Services as required during each Financial Year after the Initial Period (clause 5.1).

69. The Ongoing Management Services include, amongst other things:

- maintaining a minimum of 400 trees consisting of 100 Sandalwood trees, 100 Rosewood trees, 100 Acacia trees and 100 Cathormium trees per Woodlot from known high yielding stock in a healthy condition in the 12 months after the Initial Period;
- grow and tend the trees on the Woodlot in accordance with good forestry practice;
- control weeds and pests;
- maintain existing roads, tracks and fences;
- prevent or combat land degradation on the Grower's Woodlot and surrounding land;
- replant such trees as are necessary to ensure that each Woodlot has sufficient healthy trees to enable the yield projections in the PDS to be met;
- monitor and review the fire prevention program; and
- irrigate the Grower's Woodlot and Trees.

70. The Responsible Entity will also provide the Harvest Services. The Harvest Services include:

- testing the maturity of the Indian Sandalwood;
- harvesting the wood from the Trees grown on a Grower's Woodlot;
- delivering the Indian Sandalwood to a delivery point for processing and sale;
- storage of the Indian Sandalwood; and
- processing or procuring the processing of the Indian Sandalwood ready for sale.

71. The Responsible Entity will also provide the Marketing and Sales Services. The Marketing and Sales Services include:

- supervising and managing the negotiation and making of sales of the Forest Produce;
- supervising and managing the writing of a marketing plan;
- maintaining an international database of all potential buyers of Indian Sandalwood in the years preceding the Harvest;
- maintaining contact with potential buyers; and
- generating interest in Indian Sandalwood as an end product.

### **Operational Management Agreement**

72. Under the Operational Management Agreement the Responsible Entity will engage the Operational Manager, Capricorn Timber Plantations Pty Ltd, to manage the Project in accordance with the Constitution and Licence and Management Agreement as if the Operational Manager was the Responsible Entity, with the exception of duties that are the specific statutory responsibility of the Responsible Entity (clause 5).

73. Under clause 5.2 the Operational Manager agrees (among other things) to hire, direct and/or discharge all contractors and employees required for the Project.

74. In performing the services in the Operational Management Agreement, the Operational Manager will be subject to the supervision of the Responsible Entity (clause 5.6).



## **Operations Agreement**

75. Under the Operations Agreement, the Operational Manager will engage the Contractor, Capricorn Timber Management Pty Ltd, as an independent contractor to carry out the Forestry Management Services (as defined in the Operations Agreement) from 1 July 2008 until the earlier of the termination of the Project or the termination of the Operations Agreement (clauses 3.1 and 4).

## **Pooling of Timber and Grower's Entitlement to Net Proceeds**

76. The Constitution and the Licence and Management Agreement set out provisions relating to the Grower's entitlement to Grower's Business Income (clauses 18.1 and 8.1 respectively).

77. The Grower's Business Income is the amount left after deduction of the Harvest Fees and Marketing and Sales Fees from the Product Sale Proceeds, together with any other amounts which would be included in the Grower's taxable income from the carrying on of the Grower's Business.

78. The Product Sale Proceeds is the proportion of the Gross Sales Proceeds from sale of the Product Pool that is attributable to the Indian Sandalwood trees harvested from the Grower's Woodlot as a proportionate share of all Woodlots harvested and included in the Product Pool. The Product Pool is the Wood produce from the Woodlots of Growers in the Project including the Grower's Woodlot, with respect to which the Responsible Entity has pooled in accordance with the Licence and Management Agreement.

79. All Growers Business Income received by the Responsible Entity for a Grower must be paid by the Responsible Entity into the Scheme Bank Account (Constitution clause 18.1).

80. The Responsible Entity is entitled to deduct from the Growers Business Income prior to payment to the Grower:

- any outstanding fees payable by Growers;
- any other costs of the Scheme not required to be borne by the Responsible Entity out of the fees; and
- such tax and duty determined by the Responsible Entity to be payable out of the Growers Business Income pursuant to clause 18.6 of the Constitution (Constitution clause 18.5).

81. The Licence and Management Agreement sets out provisions relating to the pooling of Indian Sandalwood harvested from the Grower's Woodlots (clause 8.2).

82. Where pooling takes place, in working out the Grower's Business Income, the proportion of the Product Sale Proceeds applicable to the Grower is the portion of the Product Pool that is attributable to the Grower's Woodlot as a proportion of all Woodlots harvested.

83. If a Grower's Woodlot is destroyed or partially destroyed, the Grower's Product Sale Proceeds, as a share of the Gross Sales Proceeds for all Growers, will be reduced in accordance with the proportion of loss of the Woodlot sustained.

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

- only Growers who have contributed to the Product Pool are entitled to benefit from distributions of Harvest Proceeds from the pool; and
- any pooled Indian Sandalwood must consist only of Indian Sandalwood contributed by Growers accepted to participate in the Project in the same income year.

### **Fees**

85. Under the terms of the Constitution and the Licence and Management Agreement, each Grower will make payments as described below on a 'per Woodlot' basis.

#### ***Fees payable under the Constitution and the Licence and Management Agreement***

86. The **Establishment Fee** of \$16,000 is to be paid on the Settlement Date for the provision of the Establishment Services in the Initial Period.

87. The **Ongoing Management Fees**, for provision by the Responsible Entity of the Ongoing Management Services, are payable to the Responsible Entity in each income year, commencing with the income year ended 30 June 2010.

88. The Ongoing Management Fees will be payable by 31 December of each year. After the income year ended 30 June 2010, the Ongoing Management Fees will increase by 3% per year.

89. The **Harvest Fee** of 5.5% of the Product Sale Proceeds is payable to the Responsible Entity for provision of the Harvest Services.

90. The **Marketing and Sales Fee** of 2.75% of the Product Sale Proceeds is payable to the Responsible Entity for provision of the Marketing and Sales Services.

#### ***Fees payable in respect of the Licence***

91. Each Grower must pay the Responsible Entity **Occupation Fees** for the licence of the Woodlot. The amount of the Occupation Fee is \$412.50 per Woodlot, payable in respect of each income year, commencing with the income year ended 30 June 2010.

92. The Occupation Fees will be payable by 31 December each year.

93. After the income year ended 30 June 2010, the Occupation Fees will be increased by 3% per year.

## **Finance**

94. A Grower who does not pay the Establishment Fee in full upon application can borrow from the Preferred Financier, or borrow from an independent lender external to the Project.

95. 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 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.

96. Growers cannot rely on any part of this Ruling if the Establishment 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.

### ***Finance offered by the Preferred Financier***

97. A Grower can finance the cost of their Establishment Fee by borrowing that amount from the Preferred Financier (as the Lender).

98. Subject to the Preferred Financier accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

99. The loans offered by the Preferred Financier include the following terms:

- Terms available are:
  - 10 years principal and interest;
  - 3 years interest only followed by 7 years principal and interest;
  - 2 years interest only followed by 5 years principal and interest; or
  - 5 years principal and interest,
- a minimum loan amount of \$5,000;
- a maximum loan amount of \$500,000;
- no minimum deposit;

- a loan establishment fee of \$295 plus 1.00% of the amount financed, plus stamp duty of 0.20%;
- equal monthly repayments payable in arrears;
- the first repayment will be due on 30 July 2008; and
- interest fixed at the current market rate per annum, applicable at the Settlement Date, for the term of the loan.

100. 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 Preferred Financier, are involved or become involved in the provision of finance to Growers for the Project.

## Appendix 1 – Explanation

**❶** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### **Is the Grower carrying on a business?**

101. For the amounts set out in paragraphs 24 and 28 of this Ruling to constitute allowable deductions the Grower's afforestation activities as a participant in the Project must amount to the carrying on of a business of primary production.

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

103. 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?

104. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Project. 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.

105. Having applied these principles to the arrangement set out above, a Grower in the Project is accepted to be carrying on a business of growing and harvesting Indian sandalwood for sale.

### **Deductibility of the Establishment Fee, Ongoing Management Fees, Occupation Fees and loan interest**

#### **Section 8-1**

106. The Establishment Fee, Ongoing Management Fees, and Occupation Fees are 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 fees (see paragraphs 49 to 51 of TR 2000/8).

107. 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 110 to 120 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.)

108. Some Growers may finance their participation in the Project through a loan agreement with the Preferred Financier. Applying the same principles as that used for the fees referred to in paragraph 106 of this Ruling, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

109. Other than where the prepayment provisions apply (see paragraphs 110 to 114 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

### **Prepayment provisions**

#### ***Sections 82KZL to 82KZMG***

110. 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.

111. 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 of 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***

112. Other than the Establishment Fee (see below), the fees payable under the scheme to which this Product Ruling applies are either payable out of harvest proceeds, or are incurred annually for services to be wholly provided in the income year in which those fees are incurred, and the interest payable to the Preferred Financier is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application.

113. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project chooses to prepay all or some of the expenditure payable under the Constitution and the Licence and Management Agreement or chooses or is required to prepay interest under a loan agreement (including loan agreements with lenders other than the Preferred Financier).

114. As stated in Note (iii) of paragraph 28 of this Ruling, prepayments of interest are not covered by this Product Ruling and Growers who make such prepayments may instead request a private ruling on the tax consequences of the prepaid interest.

**Section 82KZMG**

115. 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.

116. Section 82KZMG provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure<sup>4</sup> incurred under an 'agreement for planting and tending trees for felling' (subsection 82KZMG(3) of the ITAA 1936).

117. 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 (subsection 82KZMG(4) of the ITAA 1936). Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12.

118. 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 income year following the 'expenditure year' (see subsections 82KZMG(1) and (2) of the ITAA 1936).

119. Under the Constitution and the Licence and Management Agreement each Grower incurs an Establishment Fee of \$16,000 per Woodlot in the income year ended 30 June 2008 for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the Indian sandalwood trees.

120. The expenditure for 'seasonally dependent agronomic activities' meets all other requirements of section 82KZMG of the ITAA 1936 and, therefore, other than where section 82KZMGA applies (see paragraphs 121 to 123 of this Ruling), 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 Fee.

**'CGT event' within 4 years for Growers who are initial participants****Section 82KZMGA**

121. A Grower who is an initial participant in the Project cannot deduct an amount that meets the requirements of section 82KZMG of the ITAA 1936 if a 'CGT event' happens in relation to the Grower's interest within 4 years of 30 June 2008 (subsection 82KZMGA(1) of the ITAA 1936). In this Project, only the Establishment Fee meets the requirements of section 82KZMG of the ITAA 1936. Accordingly, the deduction of \$16,000 per 'interest' for the Establishment Fee will not be allowable if a 'CGT event' happens to the Grower's interest within the 4 year period.

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<sup>4</sup> The expenditure must be incurred on or before 30 June 2008 (subsection 82KZMG(2) of the ITAA 1936).

122. Where subsection 82KZMGA(1) of the ITAA 1936 applies, the Commissioner may amend any affected Grower's assessment within 2 years after the end of the income year in which the 'CGT event' happens. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 82KZMGA(2) of the ITAA 1936).

123. A Grower whose deduction for the Establishment Fee is disallowed because of section 82KZMGA is still required to include in their assessable income the market value of the interest at the time of the 'CGT event' or the decrease in the market value of the interest as a result of the 'CGT event' (section 82KZMGB of the ITAA 1936).

### **Assessable income from 'CGT events' for Growers who are initial participants**

#### ***Sections 6-10, 10-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936***

124. Section 6-10 of the ITAA 1997 includes in assessable income amounts that do not constitute ordinary income. These amounts, called statutory income, are listed in the table in section 10-5 of the ITAA 1997 and include amounts that are included in the assessable income of a Grower by section 82KZMGB of the ITAA 1936.

#### ***Section 82KZMGB***

125. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)<sup>5</sup> happens to an interest held by a Grower who is an initial participant in this Project, section 82KZMGB of the ITAA 1936 includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted the Establishment Fee (shown in paragraph 24 of this Ruling); and
- subsection 82KZMG(1) of the ITAA 1936 applies to the timing of the deduction of the Establishment Fee (or would apply if section 82KZMGA of the ITAA 1936 were disregarded – see above).

### **Market value rule applies to 'CGT events'**

126. If, as a result of the 'CGT event' the Grower either:

- no longer holds the interest; or
- otherwise – where the Grower continues to hold the 'forestry interest' but there is a decrease in the market value of the interest;

<sup>5</sup> A thinning under this scheme is not a 'CGT event'.



then the market value of the interest at the time of the event, or the decrease in market value of the interest as a result of the event, is included in the assessable income of the Grower (subsection 82KZMGB(2) of the ITAA 1936). A market value rule applies rather than the amount of money actually received from the CGT event (subsection 82KZMGB(3) of the ITAA 1936). However, the market value and the actual amount of money received may be the same.

127. The market value amount included in the assessable income of a Grower is the value of the interest just before the 'CGT event', or where the Grower continues to hold their interest after the 'CGT event', the amount by which the market value of the interest is reduced by the 'CGT event' (subsection 82KZMGB(2) of the ITAA 1936).

128. This provision will apply where the interest is sold, is extinguished, or ceases, and will include 'CGT events' such as a full or partial sale of the interest or from a full or partial clear-fell harvest of the trees grown under the Project.

## **Anti-overlap provisions**

### ***Section 118-20***

129. Generally, where as a result of a 'CGT event' a capital gain would otherwise be included in a taxpayer's assessable income, section 118-20 will apply to reduce the capital gain if, because of the event, a provision of the income tax law other than the CGT provisions includes an amount in the taxpayer's assessable income.

130. In the case of interests held by Growers who are initial participants in this Project the market value, or the reduction in the market value of the interest from a CGT event is included in assessable income by section 6-10 of the ITAA 1997 and section 82KZMGB of the ITAA 1936. Therefore, section 118-20 of the ITAA 1997 will operate to reduce to nil any capital gain that would otherwise be assessable under the CGT provisions in Part 3-1 of the ITAA 1997.

## **Borrowing costs**

### ***Section 25-25***

131. A deduction is allowable for expenditure incurred by a Grower in borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income (subsection 25-25(1)).

132. In this Project, the Loan Establishment Fee payable to the Preferred Financier is incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

133. The deduction for the borrowing expense is spread over the period of the loan or 5 years, whichever is the shorter (subsection 25-25(4)).

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

134. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ended 30 June 2008 to 30 June 2023, the Commissioner has applied the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner’s discretion. 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.

135. 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.

136. 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**

137. 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**

138. 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).

139. The Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 24 and 28 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.

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

## **Appendix 2 – Detailed contents list**

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## References

### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

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

### *Subject references:*

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

### *Legislative references:*

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZLA
- 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 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
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- ITAA 1936 170
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-10
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- ITAA 1997 Div 35
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- ITAA 1997 35-55
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- ITAA 1997 118-20
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- Copyright Act 1968
- Corporations Act 2001
- SISA 1993
- TAA 1953
- TAA 1953 Sch 1 357-75(1)

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

### ATO references:

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