


# ***PR 2008/44 - Income tax: Paulownia Tree Farming Project 3B***

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## Product Ruling

### Income tax: Paulownia Tree Farming Project 3B

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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**

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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**

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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 Paulownia Tree Farming Project 3B 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 from the date this Product Ruling is made. They will have executed the relevant Project Agreements set out in paragraph 36 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 14 May 2008, the date on which this Product Ruling is made, 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 75 of this Ruling;
- have not paid the Fees for the Initial Period of \$4,000 by 30 June 2008, where they have not entered into an Instalment Option; 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 by Paulownia Farm Management Australia Ltd (the Responsible Entity) subject to finance for the payment of the Fees for the Initial Period, 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 the Responsible Entity by 28 July 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 36 to 80 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 14 May 2008, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 14 May 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.

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**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 at paragraphs 36 to 80 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 Lease and Management Agreement.

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.

**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').

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.

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

**Deductions for the Initial Management 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 four 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 Timberlot 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>Fees for the Initial Period – component relating to management fees</b>	\$3,978 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 of the ITAA 1997.
- (ii) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the amount of \$3,978 of the Fees for the Initial Period is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 98 to 103 of this Ruling) and is deductible in the income year in which it is incurred. This amount is referred to in this Ruling as the 'Initial Management Fee' or 'Initial Management Fees'.

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

25. A deduction for the amount set out in the table at paragraph 24 of this Ruling 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 104 to 106 of this Ruling).

### **Deductions for management fees and rent**

#### ***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 Timberlot 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>Management Fees (after the Initial Period)</b>	Nil	Nil	\$678 See note (i)
<b>Rent</b>	\$22 See Notes (i) & (iii)	Nil	\$22 See Note (i)

#### **Notes:**

- (iii) An amount of \$22 of the Fees for the Initial Period is payment for Rent in respect of the occupation of the Timberlot in the Initial Period, referred to in this Ruling as the 'Initial Rent'. Amounts less than \$1,000 are 'excluded expenditure' and fall within one of the exceptions to the prepayment rules in section 82KZME of the ITAA 1936 (see paragraphs 92 to 97 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' (other than a 'CGT event' in respect of a thinning<sup>4</sup> – see paragraph 33 of this Ruling) 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).

<sup>4</sup> A thinning of the trees includes a selective harvest of immature trees to facilitate better outcomes at harvest. A thinning differs from a clear fell of a percentage of mature trees which may occur over two or more income years.



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 Timberlot(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.

## **Amounts received by Growers where the Project trees are thinned**

### ***Sections 6-5 and 17-5***

33. An amount received by a Grower in respect of a thinning of the trees grown in this Project is not an amount received as a result of a 'CGT event' and is not otherwise assessable under section 82KZMGB of the ITAA 1936. The amount is a distribution of ordinary income that arises as an incident of the Grower holding an interest in the Project. Growers include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5 of the ITAA 1997) less any GST payable on those proceeds (section 17-5 of the ITAA 1997).

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

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

34. 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 2021**. 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***

35. For a Grower who commences participation in the Project and incurs expenditure as required by the Lease 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 (however, see paragraphs 92 to 97 of this Ruling);
- 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**

36. 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 11 July 2007, 28 August 2007, 2 and 5 October 2007; 15, 19 and 28 November 2007; 3 and 12 December 2007; 1 and 18 February 2008; 1, 9, 10, 20, 21, 22, 24 and 29 April 2008; 5 and 6 May 2008;
- Product Disclosure Statement for The Paulownia Tree Farming Project No. 3, received 11 July 2007;
- Draft Supplementary Product Disclosure Statement for The Paulownia Tree Farming Project No. 3 in respect of The Paulownia Tree Farming Project No. 3B received 21 April 2008;
- **Constitution** for The Paulownia Tree Farming Project No. 3, received 3 December 2007;
- **Draft Addendum to the Constitution** for The Paulownia Tree Farming Project No. 3 received 1 April 2008;
- Draft Compliance Plan for The Paulownia Tree Farming Project No. 3, received 11 July 2008;
- Draft **Lease and Management Agreement** between Paulownia Farm Management Australia Ltd (Responsible Entity) and the Grower, received 10 April 2008;

- Copy Land Lease Agreement between Rural Equities Ltd as Lessor and the Responsible Entity as Lessee, received 11 July 2007;
- Draft Land Lease Agreement Deed of Amendment – Project 3B between Rural Equities Ltd as Lessor and the Responsible Entity as Lessee, received 6 May 2008;
- Draft Plantation Sub-Contracting Agreement in respect of The Paulownia Tree Farming Project No. 3B between the Responsible Entity as Contractor and Goldzone Investments Pty Ltd as Sub-Contractor, received 3 December 2007;
- Draft Forestry Expert Consultancy Agreement between the Responsible Entity, Afforestation Pty Ltd as Consultant and a Director of the Consultant received 3 December 2007; and
- Copy Custodial Agency Agreement in respect of The Paulownia Tree Farming Project No. 3 between the Responsible Entity and the Custodian, received 11 July 2007.

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

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

38. 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.

39. The main features of the Project are as follows:

Location	Approximately 180 km North of Perth in the region of Moora, Western Australia
Type of business to be carried on by each Grower	Cultivation of <i>Paulownia fortunei</i> trees for harvest and sale
Term of the Project	16 years
Number of hectares offered for cultivation	Approximately 125 hectares
Size of each Timberlot	0.1 hectare
Minimum allocation per Grower	1 timberlot
Minimum subscription	No minimum subscription

Initial cost	\$4,000
Ongoing costs	Management Fees Rent
Other costs	Harvesting and Processing Costs Sale costs Marketing Fee Cost of insurance of Woodlot, subject to Grower's election

40. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Paulownia Farm Management Australia Ltd has been issued with an Australian Financial Service Licence No. 246892 and will be the Responsible Entity for the Project.

41. An offer to participate in the Project will be made through a Product Disclosure Statement and a Supplementary Product Disclosure Statement (these two documents will be collectively referred to in this Product Ruling as the PDS). The Responsible Entity is able to accept oversubscriptions to the extent that the Lessor has suitable land available and subject to approval by the forestry consultant to the Responsible Entity.

42. An entity that participates in the Project will do so by acquiring an interest in the Project on or before 30 June 2008.

43. Applicants execute a power of Attorney contained in the PDS. The Power of Attorney appoints the Responsible Entity to complete and execute, on behalf of the Grower, the Lease and Management Agreement.

44. Growers will only be accepted into the Project by either paying the Fees for the Initial Period in full to the Responsible Entity, entering into an arrangement with the Responsible Entity to pay those Fees by instalments, or by obtaining finance from a lender external to the Project to fund payment of those Fees. Where a Grower has applied for finance in order to fund payment of those Fees, the Grower must notify the Responsible Entity of this in their application, and the Fees must be paid in full by 28 July 2008.

45. Each Grower will use their Timberlot(s) for the purpose of carrying on a business of cultivating and harvesting Paulownia trees and the sale of harvested produce. Harvesting is expected to be completed during the year ended 30 June 2024.

46. This Ruling only applies in respect of Growers who enter the Project from 14 May 2008, the date this Product Ruling is made, to 30 June 2008.

## **Constitution**

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

48. In order to acquire an interest in the Project, the Grower must make an application for a Timberlot/s pursuant to the PDS.

49. Under clause 2.5 of the Constitution, the Custodian for the Project must deposit all application moneys received from Growers into a trust bank account established for this purpose. This account is referred to as the Application Fund.

50. The application moneys will be released from this fund when the Responsible Entity is satisfied that certain specified criteria set out in clause 14 of the Constitution have been met.

## **Compliance Plan**

51. 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.

## **Land Lease Agreement**

52. The Responsible Entity has entered into a Land Lease Agreement with Rural Equities Ltd in respect of the land to be used for the Project.

53. Under the Agreement, the Responsible Entity must use the land for the establishment, cultivation and harvesting of Paulownia trees and other agreed farm forestry trees (clause 7.1.2).

54. Under clause 4 of the Agreement, the Lessor consents to the Lessee sub-leasing the land to Sub-Lessees for the purpose of allowing the Sub-Lessees to plant Paulownia Trees.

55. The term of the Land Lease Agreement expires in 2021, however the Responsible Entity will enter into a Deed of Amendment to extend the term of the lease to 2024 for the purposes of the Project.

## **Lease and Management Agreement**

56. Growers participating in the Project will enter into a Lease and Management Agreement with the Responsible Entity

***Sub-Lease***

57. Under the Lease and Management Agreement, the Responsible Entity grants the Grower a Sub-Lease of their Timberlot for the purpose of planting, cultivating and harvesting Paulownia trees.

58. The term of the Sub-Lease is from the date of execution of the Lease and Management Agreement until the earliest of:

- the date on which the Constitution is terminated;
- the date of payment of the final distribution from the proceeds fund to the Grower; or
- 30 June 2024.

59. Under clause 8.4, the Responsible Entity consents to the plantation contractor performing the Services on the Grower's Timberlot on behalf of the Grower. The Services include services related to the establishment and maintenance of the plantation, and the harvesting and processing of the trees.

***Management***

60. Under clause 13 of the Lease and Management Agreement, each Grower engages the Responsible Entity to perform the Services.

61. The appointment of the Responsible Entity is for the same term as the term of the lease.

62. The Responsible Entity may delegate all or any of its duties or obligations under the Lease and Management Agreement to such persons as it may from time to time determine.

63. The Services are set out in Items 9 and 10 of the Schedule to the Lease and Management Agreement.

64. The Responsible Entity will complete the Services set out in Item 9 of the Schedule during the Initial Period (the period from 1 July 2008 to 30 June 2009).

65. The services to be carried out during the Initial Period include:

- pest reduction and eradication;
- preparation of the soil for planting;
- fertilising the soil;
- tending to seedlings prior to planting;
- planting 100 Paulownia trees per Timberlot.

66. In the years following the Initial Period, the Responsible Entity will maintain, supervise and manage the timber growing activities, and will perform the services set out in Item 10 of the Schedule. These include:

- cultivating and tending to the trees as and when required;
- repair damaged reticulation pipes;
- keep the Grower's Woodlot/s free of vermin, noxious weeds, pests and disease;
- coppice trees during the second and third year after the roots have established to allow new trunk growth;
- replace any trees that fail to establish or that die during the first two years of the Project;
- harvest the trees in year 8 in accordance with clause 17.1, unless the Responsible Entity reasonably believes that it would be in the best interests of the Grower for the Harvesting to be deferred; and
- harvest and process the trees in years 12, 13, 14 and 15 in accordance with clause 17.2, unless the Responsible Entity reasonably believes that it would be in the best interests of the Grower for the Harvesting to be deferred.

## **Plantation Sub-Contracting Agreement**

67. Under the Plantation Sub-Contracting Agreement, the Responsible Entity will engage the Sub-Contractor to carry out or cause to be carried out the Services with respect to the Project in a proper, efficient and diligent manner, in accordance with approved forestry practices.

68. The Services are defined in item 3 of the Schedule to the Agreement as the establishment, maintenance, supervision and management in accordance with good commercial practice, of all commercial forestry activities to be carried out on the plantation. They include planting the trees, and replanting and replacement, at the Sub-Contractor's expense, of any trees that die within two years of 1 July 2008.

69. Under clause 3 of the Agreement, the Sub-Contractor may, in its absolute discretion, delegate all of any of its duties or obligations under the Agreement to such persons as it may from time to time determine.

## **Forestry Expert Consultancy Agreement**

70. Under the Forestry Expert Consultancy Agreement, the Responsible Entity appoints Afforestation Pty Ltd (the Consultant) as Consultant of the Responsible Entity in respect of the Project, and to provide the services set out in the Agreement.

71. The Consultancy Services are described in clause 6 of the Agreement as being for the purpose of assisting the Responsible Entity in respect of all matters relating to the planting, establishment and maintenance of the Paulownia trees on the plantation on which the Project operates and to oversee all the silvicultural procedures performed by the Sub-Contractors.

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

72. The Lease and Management Agreement sets out provisions relating to the pooling of Growers' Timber and the distribution of proceeds from the sale of the Timber.

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

- only Growers who have contributed Timber to the pool are entitled to benefit from distributions from the pool; and
- Timber can only be pooled with the Timber of Growers who are of the same Project class.

### **Fees**

74. Under the terms of the Lease and Management Agreement, a Grower will make payments as described below on a per Timberlot basis:

- the Fees of \$4,000, payable to the Responsible Entity on or before 30 June 2008, comprised of \$3,978 for the provision of Management Services, and \$22 for rent;
- Management Fees payable to the Responsible Entity in each year following the Initial Period in the amount of \$678 in Year 1 (1 July 2009 to 30 June 2010), and thereafter each year in the amount set out in Item 4 of the Schedule, or indexed as set out in clause 2.8 of the Lease and Management Agreement;
- rent payable to the Responsible Entity in each year following the Initial Period in the amount of \$22 for Year 1, and thereafter each year in the amount set out in Item 5 of the Schedule, or indexed as set out in clause 2.8 of the Lease and Management Agreement;
- any insurance premium payable by the Grower under clause 21.3(b);
- the Grower's Proportional Share of Harvesting costs in Year 8;
- the Grower's Proportional Share of Harvesting and Processing Costs in Years 12, 13, 14 and 15;



- the Marketing Fees of 5.5% of the Gross Sale Proceeds; and
- the Grower's Proportional Share of Sale Costs.

## **Finance**

75. A Grower who does not pay the Fees for the Initial Period in full upon application can:

- enter into an arrangement with the Responsible Entity to pay those Fees by instalments (Instalment Option); or
- borrow from an independent lender external to the Project.

76. Only the Instalment Option arrangement set out below is covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into an arrangement for payment of fees with the Responsible Entity 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 may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

77. Other than where the Instalment Option is in place, Growers cannot rely on any part of this Ruling if the Fees for the Initial Period are not paid in full on or before 30 June 2008 by the Grower or, on the Grower's behalf, by a lending institution. However, where an application is accepted subject to finance approval by a lending institution, 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 and the funds have not been made available to the Responsible Entity by 28 July 2008.

78. Where a Grower enters into the Instalment Option, the full amount of the Fees for the Initial Period must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

## ***Instalment Option***

79. The amount due under the Instalment Option is repayable on a 'per Timberlot' basis as set out below:

- a deposit of \$1,600 payable on application, and in any event on or before 30 June 2008;
- 8 equal monthly instalments of \$100, commencing on 31 July 2008 and ending on 28 February 2009; and
- a payment of \$1,600 due on or before 31 October 2008.

80. This Ruling does not apply if any 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 in relation to the Instalment Option, are involved or become involved in the provision of finance to Growers for the Project.

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**Commissioner of Taxation**

14 May 2008

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## 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?**

81. 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.

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

83. 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?

84. 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.

85. 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 Paulownia trees for sale.

### **Deductibility of the Fees for the Initial Period**

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

86. The Fees for the Initial Period 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 those Fees (see paragraphs 49 to 51 of TR 2000/8).

87. 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 88 to 103 of this Ruling) a deduction for this amount can be claimed in the year in which it is incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

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

88. 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.

89. For this Project, the relevant prepayment provisions are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936 (operative provisions).

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

90. Other than the Initial Management Fees (see below) and the Initial Rent, 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. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to those fees.

91. The Initial Management Fee of \$3,978 is a fee to which section 82KZMG of the ITAA 1936 applies. This is discussed at paragraphs 98 to 103 of this Ruling.

92. The Initial Rent of \$22 incurred by a Grower in the Project meets the requirements of subsection 82KZME(3) of the ITAA 1936. Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of the deductions for that fee are determined under section 82KZMF of the ITAA 1936.

93. One of the exceptions is subsection 82KZME(7) of the ITAA 1936 which allows amounts of prepaid expenditure less than \$1,000 to be deductible in the year incurred. The Initial Rent is prepaid but will be less than \$1,000 where a Grower takes up to 45 Timberlots and the fees are therefore deductible in the year they are incurred – that is, the income year ending 30 June 2008.

94. Where a Grower takes more than 45 Timberlots, the amount of the Initial Rent will be more than \$1,000. As none of the other exceptions to section 82KZME of the ITAA 1936 apply, the deduction for the relevant income year is calculated using the formula in subsection 82KZMF(1) of the ITAA 1936.

95. The eligible service period for the Initial Rent commences on 1 July 2008 and ends on 30 June 2009. Application of the formula in subsection 82KZMF(1) of the ITAA 1936 results in no amount being deductible in the year ended 30 June 2008, and a deduction for the full amount of the rent payable by the Grower on 30 June 2008 being allowable in the income year ended 30 June 2009.

96. Sections 82KZME and 82KZMF of the ITAA 1936 may also have relevance if a Grower in this Project chooses or is required to prepay some or all of the expenditure payable under the Lease and Management Agreement (other than the expenditure referred to in paragraphs 91 to 95 of this Ruling).

97. As noted in the Ruling part above, Growers who prepay fees other than the fees discussed in paragraphs 91 to 95 of this Ruling are not covered by this Product Ruling and may instead request a private ruling of the tax consequences of their participation in the Project.

## **Section 82KZMG**

98. 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.

99. Section 82KZMG of the ITAA 1936 provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure<sup>5</sup> incurred under an 'agreement for planting and tending trees for felling' (subsection 82KZMG(3) of the ITAA 1936).

100. 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.

101. 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).

102. Under the Lease and Management Agreement each Grower incurs a fee of \$3,978 per Timberlot in the income year ended 30 June 2008 for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the Trees.

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<sup>5</sup> The expenditure must be incurred on or before 30 June 2008 (subsection 82KZMG(2) of the ITAA 1936).

103. 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 of the ITAA 1936 applies (see paragraphs 104 to 106 of this Ruling), a deduction is allowable in the income year ended 30 June 2008 for the amount of \$3,978.

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

***Section 82KZMGA***

104. 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 Initial Management Fee meets the requirements of section 82KZMG. Accordingly, the deduction of \$3,978 per 'interest' for the Initial Management Fees will not be allowable if a 'CGT event' happens to the Grower's interest within the 4 year period.

105. 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).

106. A Grower whose deduction for the amount of \$3,978 is disallowed because of section 82KZMGA of the ITAA 1936 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***

107. 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**

108. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)<sup>6</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 Initial Management 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 Initial Management Fee (or would apply if section 82KZMGA of the ITAA 1936 were disregarded – see above).

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

109. 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,

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.

110. 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).

111. 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.

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<sup>6</sup> A thinning under this scheme is not a 'CGT event'.

**Anti-overlap provisions****Section 118-20**

112. 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.

113. 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.

**Amounts received by initial participants where the Project trees are thinned****Section 6-5**

114. Section 82KZMGB of the ITAA 1936 specifically excludes from its operation a 'CGT event' that happens in respect of a thinning (see paragraph 82KZMGB(1)(d) of the ITAA 1936).

115. Thinning amounts received by a Grower who is an initial participant in this Project do not arise as a result of a 'CGT event' and are not otherwise assessable under section 82KZMGB of the ITAA 1936. The receipt of an amount arising from a thinning of the Project trees is a distribution that arises as an incident of the Grower holding an interest in the Project. It is an item of ordinary income and is assessable under section 6-5 of the ITAA 1997 in the year in which it is derived.

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

116. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2008 to 30 June 2021**, 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 Paulownia growing industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

117. 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.

118. 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**

119. 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**

120. 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).

121. 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 that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

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

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## References

### Previous draft:

Not previously issued as a draft

### Related Rulings/Determinations:

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
- forestry agreement
- for certain forestry expenditure
- 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 82KZM
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- ITAA 1936 82KZMB
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- Copyright Act 1968
- Corporations Act 2001
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