



PR 2009/42 - Income tax: 2009 AIL Red Ironbark Project

 This cover sheet is provided for information only. It does not form part of *PR 2009/42 - Income tax: 2009 AIL Red Ironbark Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *10 June 2009*



Product Ruling

Income tax: 2009 AIL Red Ironbark Project

Contents Para

**LEGALLY BINDING
SECTION:**

What this Ruling is about 1

Date of effect 12

Withdrawal

Ruling 18

Scheme 47

**NOT LEGALLY BINDING
SECTION:**

Appendix 1:

Explanation 103

Appendix 2:

Detailed contents list 151

! 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives 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. The Commissioner recommends 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 or the entities that 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. In this Product Ruling this scheme is referred to as the '2009 AIL Red Ironbark Project', or simply as 'the Project'.
2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Product Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Product Ruling, terms defined in the Project agreements have been capitalised.

Class of entities

3. 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.
4. 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 in this Product Ruling as Participants.
5. Participants are those entities that:
 - meet the definition of 'initial participant' in subsection 394-15(5); and
 - are accepted to take part in the scheme specified below on or after the date this Product Ruling is made.
6. A Participant will have executed the relevant Project Agreements set out in paragraph 47 of this Ruling on or before 30 June 2009 and will hold a 'forestry interest' in the Project.
7. The class of entities who can rely on this Product Ruling does **not** include Participants who:
 - are accepted into this Project before the date of this Ruling or after 30 June 2009;
 - participate in the scheme through offers made other than through the Product Disclosure Statement (PDS), or who enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent advisor that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits or harvest returns) in any way;

- Participants whose application price, including all loan monies, is not paid in full to Almond Investors Limited by 30 June 2009, either by the Participant and/or on the Participants behalf by a lending institution; or
- Participants who enter into finance arrangements with Almond Investors Finance Pty Ltd other than those described at paragraphs 93 to 101 of this Ruling.

Superannuation Industry (Supervision) Act 1993

8. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Commissioner 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.

Qualifications

9. 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 47 to 102 of this Ruling.

10. 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.

11. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Copyright Law Branch
Attorney-General's Department
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

12. This Product Ruling applies prospectively from 10 June 2009, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 10 June 2009 until 30 June 2009, 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 all income years up to the income year in which the scheme is terminated in accordance with the Constitution.

13. 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.

Changes in the law

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

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

Note to promoters and advisers

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

Goods and Services Tax

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

Ruling

Structure of the Project

18. The 2009 AIL Red Ironbark Project is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of Red Ironbark (*Eucalyptus Tricarpa*) trees, for felling in Australia.

19. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for an 'initial participant'¹ in the defined class of entities (see paragraphs 4 to 7 of this Ruling) who is accepted to participate in the 'forestry managed investment scheme' described below at paragraphs 47 to 102 of this Ruling on or after 10 June 2009 and on or before 30 June 2009.

20. An entity that takes part in the Project as a 'subsequent participant'² is not covered by this Product Ruling but may request a private ruling on their participation in the Project. A 'subsequent participant' is an entity that does not meet the definition of 'initial participant' in subsection 394-15(5).

Carrying on a business

21. Although not relevant for the purposes of Division 394, a Participant (as described in paragraphs 4 to 7 of this Ruling), who will stay in the Project until it is completed, will be considered to be carrying on a business of primary production. Such Participants who are individuals will be subject to the operation of Division 35 of the ITAA 1997 (see paragraphs 44 and 45 of this Ruling).

Concessions for 'small business entities'³

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 Participants who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

¹ See subsection 394-15(5).

² See section 394-30.

³ The meaning of 'small business entity' is explained in section 328-110.

The '70% DFE rule' and the establishment of the trees***Section 394-35 and subsection 394-10(4)***

24. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by the Responsible Entity of the Project. The Responsible Entity is the 'forestry manager' as defined in Division 394. On the basis of that information, the Commissioner has decided that on 30 June 2009, it will be reasonable to expect that the '70% DFE rule'⁴ will be satisfied. The Tax Office may undertake review activities during the term of the Project to verify the information relied on for the purposes of the 70% DFE rule.

25. The Ruling will only apply if the Responsible Entity establishes all of the trees that were intended to be established under the Project within 18 months of the end of the income year in which the first 'participant' in the Project is accepted⁵. For this Project the trees must be established before 31 December 2010.

26. In the context of this Project, the trees will be established when they are planted on the Land acquired for the purposes of the Project at the average rate of 1000 trees per hectare. The Responsible Entity is required by section 394-10 of Schedule 1 of the *Taxation Administration Act 1953* (TAA) to notify the Tax Office if the trees are not established by 31 December 2010.

Allowable deductions***Sections 8-5, 394-10 and 394-20 and Division 27***

27. A Participant in the Project can claim deductions for the amounts shown in the Table below that are paid to the Responsible Entity (sections 8-5 and 394-10).

28. The deductibility of these amounts remains subject to a requirement that a CGT event⁶ does not happen in relation to the Participant's 'forestry interest' before 1 July 2013 (see paragraphs 32 to 34 of this Ruling).

29. The amount is deductible in the income year in which it is paid, or is paid on behalf of the Participant (subsection 394-10(2) and section 394-20). Where a Participant does not fully pay an amount, or it is not fully paid on their behalf in an income year, it is deductible only to the extent to which it has been paid. Any unpaid amount is then deductible in the year or years in which it is actually paid.

⁴ The '70% DFE rule' is set out in section 394-35.

⁵ See subsection 394-10(4).

⁶ Defined in section 995-1.

30. If the Participant 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.

31. Amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

Fee	Amount	Year(s) deductible
Application price	\$4,900 See Note (i)	2009
Lease fee	As paid See Note (ii)	Any year in which the relevant amount is paid
Supervision fee	As paid See Notes (iii) and (v)	Any year in which the relevant amount is paid
Harvesting and transport fee	8.8% of the amount of Gross Log Harvest Proceeds in relation to each of the first two thinning 4.4% of the amount of Gross Log Harvest Proceeds in relation to each of the subsequent thinning and the final harvest See Note (v)	Any year in which the relevant amount is paid
Incentive fee	Must be calculated See Notes (iv) and (v)	Any year in which the relevant amount is paid

Notes:

- (i) The application price includes:
- \$4,293.90 for the management fee;
 - \$460.90 for the lease fee in respect of years 1 to 8; and
 - \$145.20 for the supervision fee in respect of years 1 to 8.
- (ii) This amount is in addition to the lease fee amount included in the application price and is payable by the relevant Participant as follows:
- the lease fee in respect of years 9 to 11 is \$198 in total and will be deducted from the Gross Harvest Proceeds in approximately year 8;

- the lease fee in respect of years 12 to 14 is \$212.30 in total and will be deducted from the Gross Harvest Proceeds in approximately year 11;
 - the lease fee in respect of years 15 to 17 is \$228.80 in total and will be deducted from the Gross Harvest Proceeds in approximately year 14; and
 - the lease fee in respect of years 18 to 22 is \$333.30 in total and will be deducted from the Gross Harvest Proceeds in approximately year 17.
- (iii) This amount is in addition to the supervision fee amount included in the application price and is payable by the relevant Participant as follows:
- the supervision fee in respect of years 9 to 11 is \$62.70 in total and will be deducted from the Gross Harvest Proceeds in approximately year 8;
 - the supervision fee in respect of years 12 to 14 is \$67.10 in total and will be deducted from the Gross Harvest Proceeds in approximately year 11;
 - the lease fee in respect of years 15 to 17 is \$72.60 in total and will be deducted from the Gross Harvest Proceeds in approximately year 14; and
 - the lease fee in respect of years 18 to 22 is \$105.60 in total and will be deducted from the Gross Harvest Proceeds in approximately year 17.
- (iv) The incentive fee is calculated according to the formula specified in the Management Agreement.
- (v) Participants will be notified by the Responsible Entity of the amount and the years in which these costs are paid.

‘CGT event’ within 4 years for Participants who are ‘initial participants’

Subsections 394-10(5) and 394-10(6) of the ITAA 1997 and section 170 of the ITAA 1936

32. A deduction for the application price is not allowable where a ‘CGT event’ happens in relation to the ‘forestry interest’ of a Participant before 1 July 2013 (subsection 394-10(5)).

33. Where deductions for these amounts have already been claimed by a Participant, the Commissioner may amend their assessment at any time within two years of the 'CGT event' happening (subsection 394-10(6)). The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936.

34. Participants whose deductions are disallowed because of subsection 394-10(5) are still required to include in assessable income the market value of the 'forestry interest' at the time of the 'CGT event' or the decrease in the market value of the 'forestry interest' as a result of the CGT event.

Interest on loans to finance the 'forestry interest' of a Participant, processing fee and insurance

Section 8-1

35. A Participant in the Project can claim deductions for interest incurred on a loan to fund their investment in the Project (paragraph 8-1(1)(a)). This Ruling only applies to loans between a Participant and Almond Investors Finance Pty Ltd. Participants who borrow from other financiers may apply for a private ruling on the deductibility of loan interest or may self assess the deductibility of the interest.

36. Any processing fees incurred by a Participant in this Project will be deductible under section 8-1. The deduction will be allowable in the year in which it is incurred.

37. Participants must pay an amount of \$165 on application for insurance for years 1 to 8 of the Project. Although the insurance fee is prepaid, for a Participant who acquires 6 or less interests in the Project, the amount of the prepaid insurance fee will be less than \$1,000. For the purposes of this Project, an amount of \$1,000 is excluded expenditure. Excluded expenditure is an exception to the prepayment rules and, for a Participant, is deductible in full in the year in which it is incurred. However, where a Participant acquires 7 or more interests, the prepaid insurance fee will be \$1,000 or more. The deductibility of the insurance fee for Participants who acquire 7 or more interests in the Project is outside the scope of this Ruling. Such Participants may request a private ruling on the deductibility of the insurance fee.

Borrowing costs**Section 25-25**

38. Participants will incur fees where they fund their investment in the Project through a loan with Almond Investors Finance Pty Ltd, other than the one year interest free loan. The loan application fee of up to \$500 plus 1% of the loan value payable to Almond Investors Finance Pty Ltd is a borrowing expense and is deductible under section 25-25. Where the amount is more than \$100, the deduction for the borrowing expense is spread over the period of the loan or 5 years, whichever is shorter, on a straight line basis from the date the loan begins. However, if the loan application fee is \$100 or less, the whole of the borrowing expense is deductible in the year in which it is incurred.

39. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Almond Investors Finance Pty Ltd is outside the scope of this Ruling.

Assessable income, 'CGT events' and the 'forestry interests' of Participants who are 'initial participants'**Sections 6-10, 17-5 and 394-25**

40. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁷ - see paragraph 43 of this Ruling) happens to a 'forestry interest' held by a Participant in this Project the market value of the 'forestry interest', or the decrease in the market value of the 'forestry interest', is included in the assessable income of the Participant (sections 6-10 and 394-25), less any GST payable on those proceeds (section 17-5).

41. The relevant amount is included in the Participant's assessable income in the income year in which the 'CGT event' happens (subsection 394-25(2)).

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

- a **clear-fell harvest of all or part of the trees** grown under the Project;
- the **sale, or any other disposal** of all or part of the 'forestry interest' held by the Participant; or
- any other 'CGT event' that results in a reduction of the market value of the 'forestry interest' held by the Participant.

⁷ 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.

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

43. An amount received by a Participant in respect of a thinning of the trees grown in this Project is not received as a result of a 'CGT event' and is not otherwise assessable under Division 394. The amount is a distribution of ordinary income that arises as an incident of a Participant holding a 'forestry interest' in the Project. Participants include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5) less any GST payable on those proceeds (section 17-5).

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

44. Participants who will stay in the Project until its completion will be considered to be carrying on a business of primary production. Such Participants who are individuals and accepted into the Project in the year ended 30 June 2009 may make losses from the Project that may be affected by the loss deferral rule in section 35-10. Division 35 does not apply however, to Participants who do not carry on a business.

45. The discretion in paragraph 35-55(1)(b) will be exercised for such Participants to whom the loss deferral rule would otherwise apply, for the income years ended 30 June 2009 to 30 June 2030. Exercise of the discretion in this case however is also conditional on the Project being carried out in the manner described in paragraphs 47 to 102 of this Ruling, but will allow Participants referred to who make losses, to offset them against their other assessable income in the income years in which those losses arise.

Prepayment provisions and anti-avoidance provisions**Sections 82KZM, 82KZME, 82KZMF and 82KL and Part IVA**

46. Where a Participant is accepted to participate in the Project set out at paragraphs 47 to 102 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- interest paid by a Participant to Almond Investors Finance Pty Ltd does not fall within the scope of sections 82KZM, 82KZME and 82KZMF;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

47. 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 additional information received on 16 March 2009, 25 March 2009, 26 March 2009, 16 April 2009, 20 April 2009, 21 April 2009, 23 April 2009, 24 April 2009, 28 April 2009, 29 April 2009, 5 May 2009, 12 May 2009, 13 May 2009, 15 May 2009, 25 May 2009, 26 May 2009, 27 May 2009, 28 May 2009 and 2 June 2009;
- Draft **Product Disclosure Statement** for the 2009 AIL Red Ironbark Project, received on 27 May 2009;
- **Constitution** of the 2009 AIL Red Ironbark Project between Almond Investors Limited (AIL), the Responsible Entity of the Project, and each Participant, dated 4 February 2009;
- **Supplementary Constitution** (amending the Constitution of the 2009 AIL Red Ironbark Project) dated 25 February 2009;
- **Draft Second Supplementary Constitution** (amending the Constitution of the 2009 AIL Red Ironbark Project), received on 27 May 2009;
- Compliance Plan for the 2009 AIL Red Ironbark Project, received on 26 March 2009;
- Draft Interim Head Lease between the relevant landowner and Australian Ironbark Landbank Pty Ltd (Land Company), received on 26 March 2009;
- Draft Interim Sublease for 2009 AIL Red Ironbark Project between Australian Ironbark Landbank Pty Ltd and Sandhurst Trustees Limited, received on 26 March 2009;
- Draft **Woodlot Sublease Agreement** for the 2009 AIL Red Ironbark Project, between AIL, Sandhurst Trustees Limited and each Participant, received on 26 March 2009;
- Draft **Management Agreement** for 2009 AIL Red Ironbark Project, to be entered into by AIL and each Participant, received on 27 May 2009;
- Draft Operations Agreement between AIL and Stargrow (Australia) Pty Ltd, received on 26 March 2009;
- **Draft Finance Application** for the 2009 AIL Red Ironbark Project, including the Loan Agreement between Almond Investors Finance Pty Ltd, the Preferred Financier, and a Borrower, received on 26 March 2009;

- **Draft Loan Agreement** (one year interest free loan) between Almond Investors Finance Pty Ltd and a Borrower, received on 20 April 2009;
- Custodian Agreement between AIL and Sandhurst Trustees Limited, dated 18 January 2006 and received on 26 March 2009;
- Draft Off-Take Agreement between AIL and Stargrow (Australia) Pty Ltd, received on 26 March 2009;
- Independent Forestry Report received on 26 March 2009.

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

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

49. The documents highlighted are those that a Participant 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 Participant, or any associate of a Participant, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

Overview

50. The main features of the 2009 AIL Red Ironbark Project are as follows:

Location	Box Ironbark Forest Area which is located near St Arnaud, in north central Victoria
Species of trees to be planted under the scheme	Red Ironbark (<i>Eucalyptus Tricarpa</i>)
Term of the Project	Approximately 22 years
Date all trees are due to be planted on scheme Land	31 December 2010
Number of trees per hectare	1,000
Number of hectares offered for cultivation	500 hectares
Size of each 'forestry interest'	0.5 hectares
Minimum allocation of 'forestry interests' per Participant	1

Minimum subscription	Nil
Initial cost	\$4,900 plus \$165 insurance fee
Other costs	Lease fee Supervision fee Harvest and transport fees Processing fees Incentive fee

51. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Almond Investors Limited (AIL) has been issued with an Australian Financial Service Licence 224314 and will be the Responsible Entity for the Project.

52. The Project will involve establishing, tending, felling and harvesting of red ironbark Trees for sale as firewood or sawlogs.

53. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 500 hectares, which corresponds to 1,000 'forestry interests' in the Project, however, AIL reserves the right to accept oversubscriptions.

54. Under a Power of Attorney contained in the Application Form, Applicants that are accepted to participate in the Project will enter into a Management Agreement and a Woodlot Sublease Agreement with AIL.

55. An entity that participates in the Project as a Participant will do so by acquiring a 'forestry interest' in the Project on or before 30 June 2009, which will consist of a minimum of one Woodlot of 0.5 hectares in size.

56. For the purposes of this Ruling, applicants who are accepted to participate in the Project and who execute Management Agreement on or before 30 June 2009 will become Participants in the 2009 AIL Red Ironbark Project.

57. The Land on which the Project will be conducted is in north central Victoria, near St Arnaud, 245 km northwest of Melbourne, in a region known as the Box Ironbark Forest Area.

58. A Woodlot Sublease Agreement will be entered into between the Responsible Entity, Sandhurst Trustees Limited, (the Custodian), and each Participant. Under the Woodlot Sublease Agreement, the Custodian, on behalf of the Responsible Entity, grants to the relevant Participant and the relevant Participant takes a sublease of the Participant's Woodlot to be used only for the purpose of growing, maintaining and harvesting the Trees. The Term of the Woodlot Sublease Agreement commences on the Participant Commencement Date and ends on 30 June 2031, unless terminated earlier.

59. The Land utilised by the Project must meet the requirements set out by the Independent Forestry Expert's Report.

60. Each Participant will engage the Responsible Entity as an independent contractor to manage the Participant's Woodlot and to harvest the trees from time to time and then, market, sell and otherwise deal with harvested timber and saleable timber products in accordance with its obligations under the Woodlot Sublease Agreement and Management Agreement.

Constitution

61. The Constitution establishes the Project and operates as a deed binding all Participants and the Responsible Entity (clause 2). The Constitution sets out the terms and conditions under which AIL agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Participants are bound by the Constitution by virtue of their participation in the Project.

62. In order to acquire an interest in the Project, an entity must make an application for 'forestry interests' in accordance with clauses 6 and 7. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, and accompanied by payment of the Application Money in a form acceptable to the Responsible Entity.

63. Under clause 13.1 of the Constitution, the Responsible Entity holds the Application Money on bare trust. The Responsible Entity will hold the Application Moneys received from applicants in an Application Fund (clauses 7.1 and 14, and Schedule 1 - Dictionary).

64. The Responsible Entity may transfer the Application Money where the following conditions have been satisfied:

- the Responsible Entity has issued an Interest to the Applicant, following the acceptance of the application (which occurs upon a Management Agreement for that Interest being entered);
- the Responsible Entity is ready, willing and able to perform its duties pursuant to the Woodlot Sublease and Management Agreement entered with the Applicant; and
- any matter required to be attended which is necessary for the creation of the Participants' Interests has been attended (clauses 6.6. and 14.1).

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

- the assets vested directly with each Participant (clause 7.3);
- the keeping and maintenance of a register of Participants (clause 8);
- the transfer of a Participant's interest (clause 9);

- the status, retention, cancellation and termination of Woodlot Sublease Agreement and Management Agreement (clause 11);
- the Participant's entitlement to income and distributions (clauses 15 and 16);
- the duties and rights of the Responsible Entity (clauses 18 and 20);
- the powers of the Responsible Entity, including the ability to authorise a person to act as its agent or delegate to hold title to any Project Property, perform any act or exercise any discretion within the Responsible Entity 's power (clauses 19 and 26);
- the entitlement of the Responsible Entity to be paid fees for services performed and to recover relevant costs, charges and expenses, as specified in Schedule 3 (clause 24); and
- the winding up of the Project (clause 28).

Compliance Plan

66. 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 Participants are protected.

Land

67. In order to secure tenure over the Land for the Term of the Project, a Contract of Sale of Land or an Interim Head Lease and an Interim Sublease Agreement will be executed by the relevant parties.

Interim Head Lease/Interim Sublease

68. Where a Contract of Sale has not been executed, the Land Company will enter into an Interim Head Lease with each Lessor. Each Lessor is the registered owner of the Land (clause 2(a) of the Interim Head Lease). The Land Company will subsequently enter into an Interim Sublease with the Custodian.

69. Annual Rent, as defined under clause 1.1 of the Interim Head Lease and clause 1.1 of the Interim Sublease is payable under these interim lease agreements to the relevant Lessor (clause 3 of the Interim Head Lease and clause 3 of the Interim Sub-Lease).

70. Each Lessor consents to the work that are permitted to be carried out and will be carried out on the Land in accordance with the Interim Head Lease and the Interim Sublease, including without limitation the planting of the Trees, the installation of any necessary infrastructure, and the construction and maintenance of access roads to allow access to the Land (clause 7 of the of the Interim Head Lease and clause 7 of the Interim Sublease).

71. The Interim Sublease will remain in operation after the surrender of the Interim Head Lease and all references to the Lessor will be read as to the owner of the Land (clause 15.7 of the Interim Sublease).

72. The Responsible Entity may also sublease the Land, or any part of the Land, to Participants in the 2009 AIL Red Ironbark Project. The sublease must be in the form of the Woodlot Sublease for a term that must not end later than 1 day prior to the term of the Interim Sublease (clause 12(1)(b) of the Interim Sublease).

Woodlot Sublease Agreement

73. Each Participant will execute a Woodlot Sublease with the Responsible Entity and the Custodian.

74. Each Participant is granted a sublease of the Relevant Participant's Woodlot and the Trees. The Relevant Participant's Woodlot is to be used for the purpose of establishing, growing, maintaining and harvesting the Trees (clause 2).

75. The Term of the Woodlot Sublease commences on the Participant Commencement Date and ends on 30 June 2031, unless terminated earlier in accordance with the Woodlot Sublease or the Constitution (clause 3).

76. The Responsible Entity agrees to plant each Participant's Woodlot with Trees by no later than 31 December 2010. The Responsible Entity must prepare the Relevant Participant's Woodlot so that it will be suitable for planting and growing the Trees, and plant and establish the Trees in a proper and skilful manner (clause 4).

77. The Woodlot Sublease Agreement also sets out:

- the Responsible Entity's obligations (clause 7);
- the fees and charges payable by the Grower (clause 8 and Schedule 3); and
- the termination of the Woodlot Sublease Agreement by the Participant or Responsible Entity (clause 9).

Custodian Agreement

78. The Responsible Entity appoints Sandhurst Trustee Limited as the Custodian of the Assets, on the terms of the Custodian Agreement (clause 2). The Custodian will hold scheme property separately from the assets of the Responsible Entity and the Custodian, and ensure full identification of the assets of the Scheme in the books of account of the Custodian (clause 4).

Management Agreement

79. Each Grower will enter into a Management Agreement with the Responsible Entity whereby the Participant engages the Responsible Entity as an independent contractor to manage the Participant's Woodlot (Recital A and clause 2).

80. The Responsible Entity must ensure a Woodlot Sublease Agreement is entered into, in relation to the Participant's Interest, prior to the Responsible entity commencing the Establishment Services, that is, either at the time the Participant's application to acquire an Interest is accepted or at the time when sufficient Land is available. If sufficient suitable Land is not available at the time the Participant's application to acquire an Interest is accepted, the Responsible Entity must use all reasonable endeavours to source and secure appropriate tenure of sufficient suitable Land as soon as practicable and in any event by 30 September 2010 (clause 4).

81. The Agreement will commence on the date the responsible entity accepts the participant's application for an Interest. It will continue until the later of the date when:

- all the Trees are harvested and all proceeds from the sale of the harvested Trees are received by the Manager and dealt with as required by the agreement;
- the Participant's Interest is terminated; or
- the Agreement is terminated pursuant to any provisions of this Agreement.

82. The Responsible Entity must carry out the establishment duties in a manner according to sound silvicultural, environmental and business practices.

83. The Responsible entity must , amongst other things:

- prepare the Woodlot for planting;
- acquire Trees (or seedlings) to be grown on the Woodlot and then germinate seedlings as required;
- prepare the Woodlot with adequate drainage for the Trees;
- plant, grow and take care of initial seedlings; and

- tend and maintain the Trees and Woodlots in a proper and skilful manner and when appropriate prepare, cultivate, spray herbicides and insecticides, and plant and fertilise the seedlings (clause 4.2).

84. The Responsible Entity must perform those duties by no later than 31 December 2010 (clause 4.3).

85. The Responsible Entity must continue to tend and maintain the Trees and Woodlot for the remainder of the term in a proper and skilful manner (clause 4.5).

86. The Responsible Entity also agrees to thin and harvest the trees, process the timber to 'green rough sawn timber' stage, and arrange for the marketing and sale of the Participant's Produce. The Responsible Entity will not carry out any processing of timber which is harvested from the Participant's woodlot for use as firewood (clauses 5 and 6).

87. The Management Agreement also:

- sets out the fees payable by the Participant to the Responsible Entity (clause 8);
- provides that the Participant irrevocably appoints the Responsible Entity, and the Responsible Entity accepts the appointment, to act as the Participant's agent for the purpose of arranging insurance for the Trees (clause 12); and
- sets out when the Management Agreement may be terminated (clause 15).

Operations Agreement

88. The Responsible Entity appoints Stargrow (Australia) Pty Ltd as the Manager for the Project. The Manager is engaged as an independent contractor to perform the Establishment, Management and Harvest Services pursuant to the terms and conditions of the Agreement (clause 2).

Entitlement to Net Sale Proceeds

89. The Constitution (clause 15) and the Management Agreement (clause 7) sets out provisions relating to the Participant's entitlement to harvest proceeds.

90. The Constitution provides that the Responsible Entity must collect, receive and pay into a Proceeds Fund the Gross Harvest Proceeds and any other income properly related to the proceeds of the Participant's Interest (clause 15).

91. The Constitution and the Management Agreement provides that after payment of all costs and expenses under clause 15.4 and respective clause 7.2, the Participant is entitled to their Proportional Interest of the net proceeds of sale.

Fees

92. The Fees payable by the Participant to the Responsible Entity are set out in the Constitution, the Woodlot Sublease Agreement and the Management Agreement. The following amounts are payable:

Management Agreement

- for the establishment services described in clause 4, a management fee of \$4,293.90 per Woodlot is payable upon Application, as part of the application price;
- for supervision services to be provided in the years 1 to 8, a fee of \$145.20 is payable upon Application, as part of the application price;
- for supervision services to be provided in the years 9 to 11, a supervision fee of \$62.70 is deducted from the Gross Harvest Proceeds in approximately year eight;
- for supervision services to be provided in the years 12 to 14, a supervision fee of \$67.10 is deducted from the Gross Harvest Proceeds in approximately year 11;
- for supervision services to be provided in the years 15 to 17, a supervision fee of \$72.60 is deducted from the Gross Harvest Proceeds in approximately year 14;
- for supervision services to be provided in the years 18 to 22, a supervision fee of \$105.60 is deducted from the Gross Harvest Proceeds in approximately year 17;
- for the services to be provided in relation to the first two thinning operations, a sum equivalent to 33% of the Gross Log Harvest Proceeds. This fee comprises of a harvest fee (4.4%), a transport fee (4.4%) and a processing fee (24.2%). The fee is collected out of Gross Log Harvest proceeds corresponding to each thinning;
- for the services to be provided in relation to each subsequent thinning and the final harvest of the Trees, a sum equivalent to 28.6% of the Gross Log Harvest Proceeds. This fee comprises of a harvest fee (2.2%), a transport fee (2.2%) and a processing fee (24.2%). The fee is collected out of Gross Log Harvest proceeds corresponding to each thinning or the final harvest; and
- an incentive fee calculated in accordance with the formula at clause 8.3 is deducted from the Gross Harvest Proceeds corresponding to each thinning or the final harvest.

Woodlot Sublease Agreement

- the lease fee in respect of years 1 to 8 is \$460.90 in total and is payable on Application, as part of the application price;
- the lease fee in respect of years 9 to 11 is \$198 in total and will be deducted from the Gross Harvest Proceeds in approximately year 8;
- the lease fee in respect of years 12 to 14 is \$212.30 in total and will be deducted from the Gross Harvest Proceeds in approximately year 11;
- the lease fee in respect of years 15 to 17 is \$228.80 in total and will be deducted from the Gross Harvest Proceeds in approximately year 14; and
- the lease fee in respect of years 18 to 22 is \$333.30 in total and will be deducted from the Gross Harvest Proceeds in approximately year 17.

Insurance

- An insurance fee of \$165 is payable on application, however, it does not form part of the application price. This fee is payable in respect of insurance for damage or destruction of the Woodlot(s) for Years 1 to 8 of the Project.

Finance

93. To finance the cost of their forestry interest, a Participant can:

- apply for a one year interest free loan with Almond Investors Finance Pty Ltd, an associate of the Responsible Entity;
- enter into a principal and interest finance loan agreement with Almond Investors Finance Pty Ltd; or
- borrow from an independent lender external to the project.

94. Only the finance arrangements set out below are covered by this Product Ruling. A Participant cannot rely on this Product Ruling if they enter into a finance arrangement with Almond Investors Finance Pty Ltd that materially differs from that set out in the documentation provided with the application for this Product Ruling. A Participant 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.

95. A Participant cannot rely on any part of this Ruling if the Application Monies are not paid in full on or before 30 June 2009 by the Participant or, on the Participant's behalf, by a lending institution.

96. To apply for finance with Almond Investors Finance Pty Ltd, Borrower will execute a Power of Attorney contained in the Finance Application. The Power of Attorney appoints AIL to enter into, on behalf of the Borrower, a Loan Agreement with Almond Investors Finance Pty Ltd.

97. This Ruling will not apply to Participants who enter into finance arrangements with Almond Investors Finance Pty Ltd that do not comply with the written undertaking given to the Tax Office by Almond Investors Finance Pty Ltd dated 21 April 2009 in regard to the maximum amount to be financed under the arrangement. Participants should seek assurances from Almond Investors Pty Ltd that the undertaking will be complied with.

One Year interest free loan

98. A Participant can finance their application price of \$4,900 by entering into a one year interest free loan with Almond Investors Finance Pty Ltd.

99. The Participant must repay the amount by 12 monthly instalments of 408.34 per Woodlot. The Participant must pay the instalment amount by direct debit on the 15th day of each month (clause 4.2) except for the last instalment that is due on 30 June 2010.

Principal and interest finance loan agreement with Almond Investors Finance Pty Ltd

100. Almond Investors Finance Pty Ltd will provide a principal and interest loan to fund:

- the application price of \$4,900; and
- the compulsory insurance fee for the first 8 years of \$165.

101. The loan offered by Almond Investors Finance Pty Ltd will be on the following terms and conditions:

- a maximum of 8 years repayable by equal monthly principal and interest instalments;
- a current indicative interest rate of 10.25%, once the loan is approved, the rate is fixed for the duration of the loan;
- the maximum loan will be \$325,000;
- a loan application fee of up to \$500 plus 1% of the loan value which will be added to the Loan Amount;
- the amount of each instalment is payable by direct debit on the 15th day of each month (clause 4.2);

- as security for the Secured Obligations, the Borrower grants a fixed charge over the Charged Property to Almond Investors Finance Pty Ltd (clause 6.1); and
- if the Borrower Defaults, all amounts owing by the Borrower under the Loan Agreement are immediately due and payable to Almond Investors Finance Pty Ltd on request (clause 7.2).

102. This Ruling does not apply if the finance arrangement entered into by the Participant 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 Almond Investors Finance Pty Ltd, are involved or become involved in the provision of finance to Participants 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.*

Structure of the Project

103. In return for payment of the Application Money and the other fees and expenses required to be paid under the Constitution, Management Agreement and Woodlot Sublease Agreement during the term of the Project, Participants will hold a 'forestry interest' in a 'forestry managed investment scheme'. The Project qualifies as a 'forestry managed investment scheme' because its purpose is for 'establishing and tending trees for felling in Australia' (see subsection 394-15(1)).

104. Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Participant a right to a share in the proceeds of the harvest and share of the proceeds of any thinning of the trees grown on the Project Land. That share of proceeds is determined using the number of 'forestry interests' held by a Participant as a proportion of all 'forestry interests' held by 'participants'⁸ in the Project.

Is the Participant carrying on a business?

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

106. More recently, and in relation to a managed investment scheme similar to that which is the subject of this Ruling, the Full Federal Court in *Hance v. FC of T; Hannebery v. FC of T* [2008] FCAFC 196; 2008 ATC 20-085 applied these principles to conclude that 'Participants' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

107. Application of these principles to the arrangement set out above leads to the conclusion that Participants (as described in paragraphs 4 to 6 of this Ruling), who stay in the Project until its completion, will be carrying on a business of primary production involving afforestation activities.

⁸ The term 'participant' is defined in subsection 394-15(4).

Allowable deductions***Sections 8-5, 12-5, 394-10 and 394-20***

108. Section 8-5 allows certain specific deductions to be claimed against the assessable income of a taxpayer. The list of specific deductions is shown in a table in section 12-5 and includes payments under a 'forestry managed investment scheme' that meet the requirements of subsection 394-10(1).

The '70% DFE rule'***Paragraph 394-10(1)(c) and section 394-35***

109. The threshold test for Participants in the Project to be entitled to deductions under subsection 394-10(1) is the '70% DFE rule' in paragraph 394-10(1)(c). Under that rule it must be reasonable to expect that on 30 June 2009, the amount of 'direct forestry expenditure'⁹ under the scheme will be no less than 70% of the amount of payments under the scheme¹⁰.

110. The amount of all 'direct forestry expenditure' is the amount of the net present value of all 'direct forestry expenditure' that the Responsible Entity, as 'forestry manager'¹¹ of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

111. The 'amount of payments under the scheme' is the amount of the net present value of all amounts (that is, the fees and expenses) that all current and future 'participants' in the scheme have paid or will pay under the scheme (subsection 394-35(3)).

112. Both of the above amounts are determined as at 30 June 2009 taking into account:

- the timing requirements in subsections 394-35(4) and (5);
- any amounts that can reasonably be expected to be recouped (subsection 394-35(6));
- the discount rate in subsection 394-35(7); and
- the market value rule in subsection 394-35(8).

113. Applying all of these requirements to the information provided by the Responsible Entity of the Project the Commissioner has determined that the Project will satisfy the '70% DFE rule' on 30 June 2009.

⁹ See section 394-45.

¹⁰ See subsection 394-35(1) and section 394-40.

¹¹ Defined in section 394-15(2).

The other elements for deductibility under subsection 394-10(1)

114. The requirement of paragraph 394-10(1)(d) that Participants in the Project not have day to day control over the operation of the Project (despite having a right to be consulted or give directions is clear from the Project Agreements as are the alternative elements of paragraph (e) relating to the number of Participants in the scheme and the Responsible Entity role in other managed investment schemes.

115. The final requirement for deductibility requires all the Project trees to be established within 18 months of 30 June 2009 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Ruling by the Responsible Entity indicates that all the trees required to be established under the scheme will be planted on the Project Land by 31 December 2010.

116. Accordingly, subject to the qualifications set out below, amounts paid by Participants to the responsible Entity in relation their 'forestry interests' satisfy all requirements of subsection 394-10(1). The amounts are allowable deductions in the income year in which they are paid (subsection 394-10(2)).

117. Amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

118. Where a Participant does not fully pay an amount, or the amount is not fully paid on their behalf in an income year (see section 394-20), it is deductible only to the extent to which it has been paid. The unpaid balance is then deductible in the year or years in which it is actually paid. This may occur, for example, if all or part of the amount is borrowed and the financier fails to transfer the funds to the account of the 'forestry manager' on or before 30 June in an income year.

Loss of deductions previously allowed under section 394-10(1)

119. Two situations may lead to a loss of deductions previously allowed to Participants.

120. The first of these situations will occur if the Responsible Entity fails to establish the trees on the Project Land within 18 months. Where this occurs the Responsible Entity is required to notify the Commissioner within 3 months of the end of the 18 month period (section 394-10 of Schedule 1 to the TAA).

121. The second situation where a Participant may have deductions disallowed is where a 'CGT event' happens to their 'forestry interest' within 4 years from 30 June of the income year they paid an amount under the scheme, for example, the application price (see subsection 394-10(5)).

122. For the purposes of this provision, the Commissioner is able to amend the assessment of a Participant within 2 years of the relevant 'CGT event' happening. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 394-10(6) of the ITAA 1997).

123. Where a 'CGT event' happens to the 'forestry interest' of a Participant within 4 years, the market value of the forestry interest at the time of the 'CGT event' or the decrease in the market value of the 'forestry interest' as a result of the 'CGT event' is still included in the assessable income of the Participant by section 394-25. The amount must be included in assessable income even where an amendment has disallowed or may disallow the deductions previously allowed under section 394-10.

Interest on loans to finance the 'forestry interest' of a Participant

Section 8-1

124. Where a Participant borrows money to fund their investment in the Project, the deductibility of the interest incurred on the loan monies falls for consideration under the general deduction provisions of section 8-1. If the interest incurred by the Participant is deductible under the first positive limb in subsection 8-1(1) there is no requirement to consider whether it is also deductible under the second positive limb of that provision. Court decisions show that the same basic test applies to both limbs (see *Ronpibon Tin NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431, at CLR 56; ATD 435).

125. Under the first positive limb of subsection 8-1(1) the interest incurred by a Participant will be deductible if it is incurred in gaining or producing a Participant's assessable income and is not excluded by one of the negative limbs in subsection 8-1(2).

The question of whether an outgoing [is] ... incurred in gaining or producing the assessable income is a question of characterisation (*Fletcher & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613, at CLR 17; ATC 4957; ATR 621).

To the extent that ... outgoings of interest ... can properly be characterised as of a kind referred to in the first limb of [section 8-1] they must draw their character from the use of the borrowed funds (*Fletcher*, at CLR 19; ATC 4958; ATR 623).

[T]he characterisation of interest will generally be ascertained by reference to the objective circumstances of the use to which the borrowed funds are put (*Federal Commissioner of Taxation v. Roberts* (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494; at FCR 257; ATC 4388; ATR 504).

126. Participants in the Project use the borrowed funds to acquire a 'forestry interest' in a 'forestry managed investment scheme'. The holding of that 'forestry interest' will produce assessable income for a Participant in the form of the proceeds of a full or part disposal of the 'forestry interest' or, as a proportionate share of the harvest and thinning proceeds. The tests of deductibility of interest under the first limb of subsection 8-1(1) are, therefore, met unless one of the exclusions in subsection 8-1(2) applies.

127. For the purposes of this Project, only the capital exclusion in paragraph 8-1(2)(a) is relevant. The use of borrowed funds to purchase a capital asset, such as a 'forestry interest', does not mean that the interest outgoings are on capital account (see *Steele v. Federal Commissioner of Taxation* (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139, at CLR 470; ATC 4249; ATR 148).

Interest [is a] periodic payment for the use, but not the permanent acquisition of a capital item. Therefore, a consideration of the often-cited three matters identified by Dixon J in *Sun Newspapers Ltd v. FC of T ...* assigns interest ... to revenue (*Australian National Hotels Ltd v. Federal Commissioner of Taxation* (1988) 19 FCR 234; 88 ATC 4627; (1988) 19 ATR 1575; at FCR 241; ATC 4633-4634; ATR 1582).

128. Therefore, the capital exclusion in subsection 8-1(2) does not apply to the interest and, subject only to the potential application of the prepayment provisions, a deduction for the interest 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 82KZMF

129. 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 that will not be wholly done within the same year of income as the year in which the expenditure is incurred. For schemes such as this Project, the main operative provisions are sections 82KZMD and 82KZMF of the ITAA 1936.

130. However, subsection 394-10(7) of the ITAA 1997 specifically provides that sections 82KZMD and 82KZMF of the ITAA 1936 do not affect the timing of amounts deductible under section 394-10 of the ITAA 1997.

131. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with Almond Investors Finance Pty Ltd and the insurance fee will potentially fall within the prepayment provisions.

132. The conditions applying to the loans to which this Ruling applies (see paragraphs 98 to 101 of this Ruling) do not require any prepayment of interest over the term of the loan. Accordingly, the prepayment provisions have no application to Participants who enter into those loans. If a Participant chooses to prepay interest on these loans that Participant may request a private ruling on how the prepayment provisions will affect the timing of their interest deduction.

133. Participants must pay an amount of \$165 on application for insurance for years 1 to 8 of the Project. Although the insurance fee is prepaid, for a Participant who acquires 6 or less interests in the Project, the amount of the prepaid insurance fee is less than \$1,000. For the purposes of this Project, an amount of \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Participant is deductible in full in the year in which it is incurred. However, where a Participant acquires 7 or more interests the prepaid insurance fee may be \$1,000 or more. The deductibility of the insurance fee for Participants who acquire 7 or more interests in the Project is outside the scope of this Ruling. Such Participants may request a private ruling on the deductibility of the insurance fee.

Borrowing costs

Section 25-25

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

135. In this Project the loan application fee of \$500 plus 1% of the loan value payable to Almond Investors Finance Pty Ltd 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.

136. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the amount is greater than \$100, 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)).

Assessable income, 'CGT events' and the 'forestry interests' of Participants who are 'initial participants'

Sections 6-10, 10-5 and 394-25

137. Section 6-10 includes in assessable income amounts that are not ordinary income. These amounts, called statutory income, are listed in the table in section 10-5 and include amounts that are included in the assessable income of 'initial participants' of a 'forestry managed investment scheme' by subsection 394-25(2).

Subsection 394-25(2)

138. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)¹² happens to a 'forestry interest' held by a Participant in this Project, subsection 394-25(2) includes an amount in the assessable income of the Participant if:

- the Participant can deduct or has deducted an amount under section 394-10; or
- the Participant would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 32 to 34 and paragraphs 121 to 123 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to 'CGT events'

139. If, as a result of the 'CGT event' the Participant either:

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

then the market value of the 'forestry interest' at the time of the event, or the reduction of the market value of the 'forestry interest' as a result of the event, is included in the assessable income of the Participant in the income year in which the 'CGT event' happens (subsection 394-25(2)). A market value rule applies rather than the amount of money actually received from the 'CGT event' (subsection 394-25(3)). However, the market value and the actual amount of money received may be the same.

140. The market value amount included in the assessable income of a Participant is the value of the 'forestry interest' just before the 'CGT event', or where the Participant continues to hold their interest after the event, the amount by which the market value of the 'forestry interest' is reduced as a result of the 'CGT event' (subsection 394-25(2)).

141. Section 394-25 will apply where the 'forestry interest' is sold, is extinguished, or ceases, and will include 'CGT events' such as a full or partial sale of the 'forestry interest' or from a full or partial clear-fell harvest of the trees grown under the Project.

¹² A thinning under this scheme is not a 'CGT event'.

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

142. Section 394-25 specifically excludes from the operation of Division 394 a 'CGT event' that happens in respect of a thinning (see paragraph 394-25(1)(c)).

143. Thinning amounts received by a Participant in this Project do not arise as a result of a 'CGT event' and are not otherwise assessable under Division 394. The receipt of an amount arising from a thinning of the Project trees is a distribution that arises as an incident of the Participant holding a 'forestry interest' in the Project. It is an item of ordinary income and is assessable under section 6-5 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

144. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ended 30 June 2009 up to and including 30 June 2030, 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 Participant 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 Participant's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

145. A Participant 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.

146. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) for Participants who will stay in the project until its completion 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 Participant will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL - recouped expenditure

147. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(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

148. 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).

149. The 2009 AIL Red Ironbark Project will be a 'scheme' and a Participant will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraph 31 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.

150. Participants to whom this Ruling applies will derive assessable income from holding or disposing of their 'forestry interest' in the Project. There are no facts that would suggest that Participants 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

151. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Class of entities	3
Superannuation Industry (Supervision) Act 1993	8
Qualifications	9
Date of effect	12
Changes in the law	14
Note to promoters and advisers	16
Goods and Services Tax	17
Ruling	18
Structure of the Project	18
Carrying on a business	21
Concessions for 'small business entities'	22
The '70% DFE rule' and the establishment of the trees	24
<i>Section 394-35 and subsection 394-10(4)</i>	24
Allowable deductions	27
<i>Sections 8-5, 394-10 and 394-20 and Division 27</i>	27
'CGT event' within 4 years for Participants who are 'initial participants'	32
<i>Subsections 394-10(5) and 394-10(6) of the ITAA 1997 and section 170 of the ITAA 1936</i>	32
Interest on loans to finance the 'forestry interest' of a Participant, processing fee and insurance	35
<i>Section 8-1</i>	35
Borrowing costs	38
<i>Section 25-25</i>	38
Assessable income, 'CGT events' and 'forestry interests' of Participants who are 'initial participants'	40
<i>Sections 6-10, 17-5 and 394-25</i>	40
Amounts received by Participants where the Project Trees are thinned	43
<i>Section 6-5</i>	43
Division 35 – deferral of losses from non-commercial business activities	44
<i>Section 35-55 – exercise of Commissioner's discretion</i>	44
Prepayment provisions and anti-avoidance provisions	46
<i>Sections 82KZM, 82KZME, 82KZMF and 82KL and Part IVA</i>	46
Scheme	47
Overview	50

Constitution	61
Compliance Plan	66
Land	67
Interim Head Lease/Interim Sublease	68
Woodlot Sublease Agreement	73
Custodian Agreement	78
Management Agreement	79
Operations Agreement	88
Entitlement to net sale proceeds	89
Fees	92
Finance	93
One year interest free loan	98
Principal and interest finance loan agreement with Almond Investors Finance Pty Ltd	100
Appendix 1 – Explanation	103
Structure of the Project	103
Is the Participant carrying on a business?	105
Allowable deductions	108
<i>Sections 8-5, 12-5, 394-10 and 394-20</i>	108
The '70% DFE rule'	109
<i>Paragraph 394-10(1)(c) and section 394-35</i>	109
The other elements for deductibility under subsection 394-10(1)	114
Loss of deductions previously allowed under section 394-10(1)	119
Interest on loans to finance the 'forestry interest' of a Participant	124
<i>Section 8-1</i>	124
Prepayment provisions	129
<i>Sections 82KZL to 82KZMF</i>	129
Borrowing costs	134
<i>Section 25-25</i>	134
Assessable income, 'CGT events' and the 'forestry interests'	
Participants who are 'initial participants'	137
<i>Sections 6-10, 10-5 and 394-25</i>	137
<i>Subsection 394-25(2)</i>	138
Market value rule applies to 'CGT events'	139
Amounts received by the Participants where the Project trees are thinned	142
<i>Section 6-5</i>	142
Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion	144
Section 82KL – recouped expenditure	147
Part IVA – general tax avoidance provisions	147
Appendix 2 – Detailed contents list	151

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22

Subject references:

- 4 year holding period
- 70 per cent DFE rule
- carrying on a business
- DFE
- direct forestry expenditure
- forestry interest
- forestry MIS
- interest expenses
- managed investment schemes
- market value substitution rule
- payments under the scheme
- producing assessable income
- product rulings
- reasonable expectation
- tax avoidance
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZLA
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 170
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 318
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 6-10
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(2)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 8-5
- ITAA 1997 8-10

- ITAA 1997 10-5
- ITAA 1997 12-5
- ITAA 1997 17-5
- ITAA 1997 25-25
- ITAA 1997 25-25(1)
- ITAA 1997 25-25(4)
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-55(1)(b)
- ITAA 1997 328-110
- ITAA 1997 Div 394
- ITAA 1997 394-10
- ITAA 1997 394-10(1)
- ITAA 1997 394-10(1)(c)
- ITAA 1997 394-10(1)(d)
- ITAA 1997 394-10(1)(e)
- ITAA 1997 394-10(1)(f)
- ITAA 1997 394-10(2)
- ITAA 1997 394-10(4)
- ITAA 1997 394-10(5)
- ITAA 1997 394-10(6)
- ITAA 1997 394-10(7)
- ITAA 1997 394-15(1)
- ITAA 1997 394-15(2)
- ITAA 1997 394-15(4)
- ITAA 1997 394-15(5)
- ITAA 1997 394-20
- ITAA 1997 394-25
- ITAA 1997 394-25(1)(c)
- ITAA 1997 394-25(2)
- ITAA 1997 394-25(3)
- ITAA 1997 394-30
- ITAA 1997 394-35
- ITAA 1997 394-35(1)
- ITAA 1997 394-35(2)
- ITAA 1997 394-35(3)
- ITAA 1997 394-35(4)
- ITAA 1997 394-35(5)
- ITAA 1997 394-35(6)
- ITAA 1997 394-35(7)
- ITAA 1997 394-35(8)
- ITAA 1997 394-40
- ITAA 1997 394-45
- ITAA 1997 995-1
- TAA 1953
- TAA 1953 Sch 1 394-10
- SISA 1993
- Copyright Act 1968
- Corporations Act 2001

Case references:

- Australian National Hotels Ltd v. Federal Commissioner of Taxation (1988) 19 FCR 234; 88 ATC 4627; (1988) 19 ATR 1575
- Hance v. FC of T; Hannebery v. FC of T [2008] FCAFC 196; 2008 ATC 20-085
- Federal Commissioner of Taxation v. Roberts (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494
- Fletcher & Ors v. Federal Commissioner of Taxation (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613

- Ronpibon Tin NL v. Federal Commissioner of Taxation (1949) 78 CLR 47; (1949) 8 ATD 431
- Steele v. Federal Commissioner of Taxation (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139

Other references:

- Hannebery and Hance (NSD 492-493 of 2008)

ATO references

NO: 2009/3617

ISSN: 1441-1172

ATOlaw topic: Income tax – Product - timber