PR 2009/52 - Income tax: ITC Diversified Forestry Project 2009 - Late Investors

Product Ruling

Income tax: ITC Diversified Forestry Project 2009 – Late Investors

Contents Para

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(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 Product Ruling relates. In this Product Ruling this scheme is referred to as the scheme, the 'ITC Diversified Forestry Project 2009 – Late Investors', 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 'Investors'.

5. Investors 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. An Investor will have executed the relevant Project Agreements set out in paragraph 40 of this Ruling on or before 30 June 2010 and will hold a 'forestry interest' in the Project.

7. The class of entities who can rely on this Product Ruling does **not** include Investors who:

- are accepted into this Project before the date of this Product Ruling or after 30 June 2010; or
- participate in the scheme through offers made other than through the Product Disclosure Statement, or who enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent adviser that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits or harvest returns) in any way; or

- enter into finance arrangements with entities associated with the Project other than ITC Finance Pty Ltd or the Preferred Financier and other than under the arrangements specified in paragraphs 82 to 84 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). 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.

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 40 to 85 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.

Date of effect

12. This Product Ruling applies prospectively from 14 October 2009, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 14 October 2009 to 30 June 2010 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 laws enacted at the time it was issued, later amendments to the law may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to the extent of those amendments this Product Ruling will be superseded.

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

Note to promoters and advisers

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

Goods and Services Tax

17. All amounts and percentages referred to in this Product Ruling exclude the Goods and Services Tax (GST), unless otherwise specified. The transactions in respect of this scheme may, where appropriate, have GST implications. Those GST implications are outside the scope of this Product Ruling.

Ruling

Structure of the Project

18. The ITC Diversified Forestry Project – Late Investors is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of four different species (Pulpwood – predominantly *Eucalyptus globulus*, Red Mahogany – *Eucalyptus pellita*, Indian Sandalwood – *Santalum album* and Teak – *Tectona grandis*) of 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 at paragraphs 40 to 85 of this Ruling, on or after 14 October 2009 and on or before 30 June 2010.

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. An Investor (as described in paragraphs 5 to 7 of this Ruling) in the Project is not considered to be carrying on a business of primary production.

The '70% DFE rule' and the establishment of the trees

Section 394-35 and subsection 394-10(4)

22. 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 the information provided by the Responsible Entity, the Commissioner has decided that on 30 June 2009 it will be reasonable to expect that the '70% DFE rule'[3] 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'.

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[1] See subsection 394-15(5).
[2] See section 394-30.
[3] The '70% DFE rule' is set out in section 394-35.

23. The Product 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 accepted.[4] For this Project the trees must be established before 31 December 2010.

24. 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 800 trees per hectare for Pulpwood, 1,000 trees per hectare for Red Mahogany and Teak and 500 trees plus 2,165 host trees for Sandalwood. The Responsible Entity is required by section 394-10 of Schedule 1 of the 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

25. An Investor in the Project can claim deductions for the amounts shown in the Table below (on a **per 'forestry interest'** basis) that are paid to the Responsible Entity (sections 8-5 and 394-10).

Fee	Amount	Income Year(s) deductible
Application Fee	$7,000	2010
Deferred Management fee	35% of Net Product Sales Proceeds	Any year in which this amount is paid See Note (i)
Harvest Services fees	Actual Cost	Any year in which this amount is paid See Note (i)
After Harvest Services fee	Actual Cost	Any year in which this amount is paid See Note (i)

Note:

(i) Investors will be notified by the Responsible Entity of the amount and the years in which these costs are paid.

26. The deductibility of these amounts remains subject to a requirement that a CGT event[5] does not happen in relation to the Investor's 'forestry interest' before 1 July 2014 (see paragraphs 28 to 30 of this Ruling).

[4] See subsection 394-10(4).
[5] Defined in section 995-1.

27. The amounts are deductible in the income year in which they are paid, or are paid on behalf of the Investor (subsection 394-10(2) and section 394-20). Where an Investor 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 income year or income years in which it is actually paid.

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

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

28. A deduction for the Application Fee is not allowable where a ‘CGT event’ happens in relation to the ‘forestry interest’ of an Investor before 1 July 2014 (subsection 394-10(5)).

29. Where a deduction for this amount has already been claimed by an Investor 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.

30. Investors 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 an Investor

Section 8-1

31. An Investor in the Project can claim deductions for interest incurred on a loan with the Preferred Financier to fund their investment in the Project (paragraph 8-1(1)(a)). This Product Ruling only applies to interest on loans between an Investor and the Preferred Financier on the terms described at paragraphs 84 and 85 of this Ruling. Investors who incur interest expenses on borrowings from other financiers may apply for a private ruling on the deductibility of loan interest or may self assess the deductibility of the interest.

Borrowing costs

Section 25-25

32. Investors will incur fees when they fund their investment in the Project. The loan application fee payable to ITC Finance Pty Ltd will be $250 or such lesser amount as ITC Finance Pty Ltd may, in its absolute discretion, nominate as the loan application fee. The establishment fee payable to the Preferred Financier is the greater of $250 or 0.25% of the Principal Amount.

33. These amounts are borrowing expenses and are deductible under section 25-25. Where the loan application fee is $100 or less, the whole of the borrowing expense is deductible in the year in which it is incurred. 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.

34. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than ITC Finance Pty Ltd and the Preferred Financier is outside the scope of this Product Ruling.

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

Sections 6-10 and 394-25

35. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning[6] – see paragraph 38 of this Ruling) happens to a 'forestry interest' held by a Investor 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 Investor (sections 6-10 and 394-25).

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

37. '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 Investor; or
- any other 'CGT event' that results in a reduction of the market value of the 'forestry interest' held by the Investor.

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[6] 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 Investors where the Project trees are thinned

Section 6-5

38. An amount received by an Investor 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 an Investor holding a 'forestry interest' in the Project. Investors include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5).

Non commercial losses, prepayment provisions and anti-avoidance provisions

Division 35 of the ITAA 1997 and sections 82KZM, 82KZME, 82KZMF, 82KL and Part IVA of the ITAA 1936

39. Where an Investor is accepted to participate in the Project set out at paragraphs 40 to 85 of this Ruling, the following legislative provisions have application as indicated:

- losses arising from participation in the Project are not within the scope of Division 35 of the ITAA 1997;
- interest paid by an Investor to the Preferred Financier does not fall within the scope of sections 82KZM, 82KZME and 82KZMF of the ITAA 1936;
- section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA of the ITAA 1936 will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Product Ruling.

Scheme

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

- Application for a Product Ruling as constituted by the following documents and additional correspondence including e-mails received on 24 August 2009, 25 August 2009, 22 September 2009 and 2 October 2009;
- Product Disclosure Statement for the ITC Diversified Forestry Project 2009, received 24 August 2009;

- Draft Supplementary Product Disclosure Statement for the ITC Diversified Forestry Project 2009, received 24 August 2009
- Draft **Constitution** for the ITC Diversified Forestry Project 2009 between ITC Project Management Limited and each Investor, received 21 October 2008;
- Compliance Plan for the ITC Diversified Forestry Project 2009, received 21 October 2008;
- Draft Forestry Management Agreement for the ITC Diversified Forestry Project 2009 between ITC Project Management Limited and ITC Limited, received 21 October 2008;
- Leases between the Lessor and ITC Project Management Limited dated 22 November 2007, 21 October 2008 and 10 September 2008; and
- Draft **Loan Application** and **Loan Agreement** for loans from the Preferred Financier, received 18 December 2008 and 4 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.

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

42. The documents highlighted are those that an Investor may enter into. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor, or any associate of an Investor, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows:

Overview

43. The main features of the ITC Diversified Forestry Project 2009 – Late Investors are as follows:

Location	Pulpwood – Albany, Esperance and/or Green Triangle regions Indian Sandalwood – Ord River Irrigation Area (Kununurra, WA) and/or Lakeland region of Far North Queensland Teak and Red Mahogany – coastal strip of Far North Queensland

Species of trees to be planted under the scheme	Pulpwood species – predominantly Tasmanian Blue Gum Indian Sandalwood Teak Red Mahogany
Term of the Project	Approximately 20 years from planting
Date all trees must be planted on scheme land	31 December 2010
Average number of trees per hectare	• Pulpwood – 800 trees per hectare: • Red Mahogany and Teak – 1,000 trees per hectare; and • Sandalwood – 500 trees plus 2,165 hosts.
Number of hectares offered for cultivation	8,700 approximately
Size of each 'Plantation Unit'	1 hectare approximately
Minimum allocation of Plantation Units per Investor	1
Minimum subscription	Nil
Initial cost	$7,000
Other costs	Deferred Management fee equal to 35% of the Net Product Sale Proceeds Harvest Services fee After-Harvest Services fee Optional insurance

44. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. ITC Project Management Limited has been issued with an Australian Financial Service Licence Number 247019 and will be the Responsible Entity for the Project.

45. The Project will involve establishing, tending, felling and harvesting Tasmanian Blue gum (or other suitable pulpwood species), Indian Sandalwood, Teak and Red Mahogany trees in multiple locations across mainland Australia for the purpose of selling the timber and/or timber products.

46. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 8,700 hectares, which corresponds to 8,700 Plantation Units in the Project. ITC Project Management Limited can accept subscriptions in excess of this level, subject to suitable land being sourced. There is no minimum subscription for the Project.

47. An entity that participates in the Project as an Investor will do so by acquiring a 'forestry interest' in the Project, which will consist of a minimum of 1 Plantation Unit each of approximately 1 hectare in size, on or before 30 June 2010.

48. Applicants enter the Project by lodging a valid application form contained in the PDS, which is accepted by the Responsible Entity by entering the Investor's application details in the register of investors.

49. For the purposes of this Product Ruling, Investors who are accepted to participate in the Project on or before 30 June 2010 will become bound by the Constitution as Investors in the 2009 Project.

50. As of the date of this Product Ruling, the Responsible Entity has secured a portion of suitable land for the Project, though it has not been formally committed to the Project at this stage. The Responsible Entity is in the process of sourcing further land for the Project. The owner of the land may be ITC Timberlands, an entity related to the Responsible Entity, or an unrelated entity.

51. Land used by the Project must meet the requirements set out in the Independent Forester's report in the PDS.

52. Each Plantation Unit consists of an area equivalent to approximately 0.75 hectares of Pulpwood, 0.1 hectares of Red Mahogany, 0.05 hectares of Indian Sandalwood and 0.1 hectares of Teak.

53. The species to be planted for each Plantation Unit are set out in the PDS and Constitution, being:

- Pulpwood – Tasmanian Blue gum (*Eucalyptus globulus*);
- Red Mahogany (*Eucalyptus pellita)*;
- Indian Sandalwood (*Santalum album*); and
- Teak (*Tectona grandis*).

54. The final Clearfell Harvest of the Teak will take place approximately 20 years after planting. Other species will be clearfell harvested prior to that time and Investors may receive returns from thinnings of certain species.

55. This Product Ruling only applies to Investors who are accepted to participate in this Project from 14 October 2009 until 30 June 2010 (Late Investors).

56. Product Ruling PR 2009/10 may apply to Investors who entered the Project from 18 March 2009 to 30 June 2009.

Constitution

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

58. In order to acquire an interest in the Project, an entity must make an application for Plantation Units in accordance with clause 17. Among other things, the application is to be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the registered office of the Responsible Entity and accompanied by payment of the application money in a form acceptable to the Responsible Entity.

59. Under clause 17.1 of the Constitution, the Responsible Entity holds the application money on bare trust. The Responsible Entity will deposit all application moneys received from applicants in the Applications Bank Account.

60. Once the Responsible Entity has accepted the application and all of the Project Documents have been executed and remain in force the application money may be transferred and applied against the fees due to the Responsible Entity (clause 17.7).

61. The Responsible Entity will use reasonable endeavours to procure the right to use Sufficient Land for the purposes of the Project (clause 11.2).

62. Under clause 13 of the Constitution, the Investors appoint the Responsible Entity with effect from the Commencement Date to perform the Services during the Term of the Project. The Services are as follows:

- Establishment Services within the Establishment Period;
- Management Services from the Commencement Date until the Termination Date;
- Harvest Services; and
- After Harvest Services.

63. The Responsible Entity may appoint any entity or entities to carry out the whole or any part of the above services.

64. The Responsible Entity may arrange for a reputable insurer to offer an insurance policy to Investors for the Investor's Insurable Interest to be insured against loss from fire, storm and any other insurable risks that may be offered by the insurer. Participation by an Investor in any such insurance policy will be voluntary.

65. In summary, the Constitution also sets out (among other things) provisions relating to:

- the Responsible Entity's powers (clause 5);
- winding up of the Project (clause 7);
- fees payable to the Responsible Entity (clause 8);
- management of the plantation (clause 13);
- transfer and transmission of Plantation Units (clause 18);
- register of Investors (clause 19);
- register of land (clause 20); and
- procedures for handling complaints (clause 6).

Compliance Plan

66. As required by the Corporations Act, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Investors are protected.

Lease

67. The Responsible Entity (as Lessee) will enter into Leases with Lessors for the Term of the Project.

68. Under the Lease the Responsible Entity is permitted to use the land for the undertaking of a tree farming business, including preparing the land as required, construction of roads and irrigation and planting, cultivating, managing and harvesting the trees and their products.

Forestry Management Agreement

69. Under the Forestry Management Agreement between the Responsible Entity and ITC Limited, the Responsible Entity will appoint ITC Limited as Forestry Manager to perform the Plantation Management Services consisting of the Establishment Services, the Services, the Harvest Services and the After Harvest Services.

70. The Forestry Manager must perform the Plantation Management Services in accordance with Good Forestry Practice and in accordance with the Plantation Management Plan.

71. In consideration for the performance of its duties under the Forestry Management Agreement, the Forestry Manager is entitled to the fees and costs set out in clause 6 and the Schedule of the Forestry Management Agreement.

Harvesting and sale and entitlement to Net Sale Proceeds

72. The Responsible Entity must provide to the Investor the Harvest Services in accordance with Good Forestry practice and when the Trees are ready to be removed for production of the Product.

73. The Responsible Entity will use reasonable endeavours to arrange the sale of the Product and to enter into sale agreements as agent for the Investors pursuant to which the Product will be sold and the Product Sale Proceeds will be paid to the Responsible Entity.

74. The Constitution sets out provisions relating to the Investor's entitlement to harvest proceeds at clause 15.

75. The Responsible Entity must pay the Product Sale Proceeds to the Proceeds Bank Account.

76. The Responsible Entity will pay all monies required to be paid by the Investor under the Constitution out of the Product Sale Proceeds including the Harvest Services fee, the Deferred Management fee and the After Harvest Services fee and pay the Forestry Income to the Investor within a reasonable time.

77. The Forestry Income is the Investor's Proportional Interest of the Net Product Sales Proceeds.

Fees

78. Under the terms of the Constitution an Investor will make payments as described below on a per 'Plantation Unit' basis:

- **Application Fee** of $7,000 payable on application for the Establishment Services during the Establishment Period;
- **Deferred Management fee** of 35% of Net Product Sales Proceeds;
- **Harvest Services fee** equal to the Harvest Services Costs; and
- **After Harvest Services fee** equal to the After Harvest Services Costs.

Finance

79. To finance all or part of the cost of their 'Plantation Unit' an Investor can enter into a finance arrangement with ITC Finance Pty Ltd, borrow from the Preferred Financier or, alternatively, borrow from an independent lender external to the Project.

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

81. An Investor cannot rely on any part of this Product Ruling if the Application Fee is not paid in full on or before 30 June 2010 by the Investor or, on the Investor's behalf, by a lending institution.

Finance offered by ITC Finance Pty Ltd

82. Subject to the terms and conditions of the relevant Loan Agreement, an Investor can finance the cost of the Application Fee by borrowing that amount from ITC Finance Pty Ltd as follows:

- One Year Interest Free Loan repayable in 12 equal monthly instalments commencing in July 2010;
- Borrowing fee of $250 or lesser amount as determined by ITC Finance Pty Ltd in its absolute discretion.

Finance offered by the Preferred Financier

83. Subject to the terms and conditions of the Loan Agreement, an Investor can finance the cost of the Application Fee by borrowing that amount from the Preferred Financier under the following arrangements:

- Long-term loan of 3, 5 or 10 year period with repayment of the principal plus interest by monthly (direct debit) payments commencing in July 2010; or
- 10 year loan with monthly payment of interest only for 3 years commencing in July 2010 followed by monthly repayment of principal and interest for 7 years; and
- An establishment fee of the greater of $250 or 0.25% of the Principal Amount and stamp duty are applicable to all loans. These amounts will be added to the total amount borrowed.

84. The loans from ITC Finance Pty Ltd and the Preferred Financier are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a charge over the Investor's interest(s) in the Project.

85. This Product Ruling does not apply if an Investor enters into an agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' 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 terms are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than ITC Finance Pty Ltd or the Preferred Financier are involved or become involved, in the provision of finance for the Project.

Commissioner of Taxation
14 October 2009

Appendix 1 – Explanation

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

86. In return for payment of the Application Fee and the other fees and expenses, required under the Project Agreements during the term of the Project, Investors 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)).

87. Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Investor a right to a share in the proceeds of the harvest and a 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 an Investor as a proportion of all 'forestry interests' held by 'participants'[7] in the Project.

Is the Investor carrying on a business?

88. 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?

89. More recently, and in relation to a managed investment scheme similar to that which is the subject of this Product 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 'Growers' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

90. Application of these principles to the arrangement set out above leads to the conclusion that an Investor (as described in paragraphs 5 to 7 of this Ruling), in the Project is not considered to be carrying on a business of primary production involving afforestation activities.

[7] The term 'participant' is defined in subsection 394-15(4).

Allowable deductions

Sections 8-5, 12-5, 394-10 and 394-20

91. 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).

92. The amounts are allowable deductions in the income year in which they are paid (subsection 394-10(2)).

93. Where an Investor 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 income year or income 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.

The '70% DFE rule'

Paragraph 394-10(1)(c) and section 394-35

94. The threshold test for Investors 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'[8] under the scheme will be no less than 70% of the amount of payments under the scheme.[9]

95. 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'[10] of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

96. 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 'investors' in the scheme have paid or will pay under the scheme (subsection 394-35(3)).

97. 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));

[8] See section 394-45.
[9] See subsection 394-35(1) and section 394-40.
[10] Defined in section 394-15(2).

- the discount rate in subsection 394-35(7); and
- the market value rule in subsection 394-35(8).

98. 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.

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

99. The requirement of paragraph 394-10(1)(d) that Investors 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 element of paragraph (e) relating to the number of Investors in the scheme and the Responsible Entity's role in other managed investment schemes.

100. 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 Product 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.

101. Accordingly, subject to the qualifications set out below, amounts paid by Investors to the Responsible Entity in relation their 'forestry interests' satisfy all requirements of subsection 394-10(1).

Loss of deductions previously allowed under section 394-10

102. Two situations may lead to a loss of deductions previously allowed to Investors.

103. 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).

104. The second situation where a Investor 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 Fee (see subsection 394-10(5)).

105. For the purposes of this provision, the Commissioner is able to amend the assessment of an Investor 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).

106. Where a 'CGT event' happens to the 'forestry interest' of an Investor 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 Investor 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 an Investor

Section 8-1

107. Where an Investor 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 Investor 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).

108. Under the first positive limb of subsection 8-1(1) the interest incurred by an Investor will be deductible if it is incurred in gaining or producing an Investor'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).

109. Investors 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 an Investor 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 thinnings 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) apply.

110. 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; (1999) 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).

111. 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

112. 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 income 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.

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

114. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with the Preferred Financier will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Product Ruling applies do not require any prepayment of interest over the term of the loan. Accordingly, the prepayment provisions have no application to Investors who enter into those loans.

115. If an Investor chooses to prepay interest on these loans that Investor may request a private ruling on how the prepayment provisions will affect the timing of their interest deductions.

Borrowing costs

Section 25-25

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

117. In this Project the application fee payable to ITC Finance Pty Ltd and the establishment fee payable to the Preferred Financier are 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.

118. As the borrowing expense 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)). However, in its discretion, ITC may charge a lesser amount as a loan application fee. If the amount charged is $100 or less, the fee will be deductible in the year in which it is incurred.

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

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

119. 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)

120. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)[11] happens to a 'forestry interest' held by an Investor in this Project, subsection 394-25(2) includes an amount in the assessable income of the Investor if:

- the Investor can deduct or has deducted an amount under section 394-10; or
- the Investor would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 28 to 30 and paragraphs 102 to 106 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

[11] A thinning under this scheme is not a 'CGT event'.

Market value rule applies to 'CGT events'

121. If, as a result of the 'CGT event' the Investor either:

- no longer holds the 'forestry interest'; or
- otherwise – where the Investor 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 Investor 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.

122. The market value amount included in the assessable income of an Investor is the value of the 'forestry interest' just before the 'CGT event', or where the Investor 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)).

123. 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 a full or partial clear-fell harvest of the trees grown under the Project.

Section 6-5 – amounts received by Investors where the Project trees are thinned

124. 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)).

125. Thinning amounts received by an Investor 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 Investor 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.

Section 82KL – recouped expenditure

126. 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. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

127. 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).

128. The ITC Diversified Forestry Project 2009 – Late Investors will be a 'scheme' and an Investor will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraph 25 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.

129. Investors to whom this Product 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 Investors have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Product 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 Investors will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
PR 2009/10

Subject references:

- 4 year holding period
- 70 per cent DFE rule
- DFE
- direct forestry expenditure
- forestry interest
- forestry MIS
- interest expenses
- 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 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)
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- ITAA 1997 10-5
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- ITAA 1997 2525
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- ITAA 1997 25-25(4)
- ITAA 1997 Div 35
- ITAA 1997 Div 394
- ITAA 1997 394-10
- ITAA 1997 394-10(1)
- ITAA 1997 394-10(1)(c)
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- ITAA 1997 394-10(1)(e)
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- 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
- 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
- Hance v. FC of T; Hannebery v. FC of T [2008] FCAFC 196; 2008 ATC 20-085
- 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

ATO references

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