



PR 2010/12 - Income tax: TFS Spicatum Project 2010

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 May 2010*



Product Ruling

Income tax: TFS Spicatum Project 2010

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

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

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

If you rely on this ruling, 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 'TFS Spicatum Project 2010', 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 'Growers'.
5. Growers 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 and on or before 30 June 2010.
6. A Grower will have executed the relevant Project Agreements set out in paragraph 55 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:
 - entities who are accepted into this Project before the date of this Product Ruling or after 30 June 2010;
 - entities who 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;
- entities whose Establishment and Ongoing Services
Fee, including all loan money, are not paid in full to TFS
Properties Ltd (Responsible Entity) by 30 June 2010;
- entities who enter into finance arrangements with
Arwon Finance Pty Ltd (Arwon), other than as specified
in paragraphs 97 to 105 of this Ruling; or
- entities who elect to collect and market their own produce.

Superannuation Industry (Supervision) Act 1993

8. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Australian Taxation Office (ATO) 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 55 to 106 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.

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Date of effect

12. This Product Ruling applies prospectively from 19 May 2010, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 19 May 2010 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 ATO 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 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 Product Ruling as a Grower) 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 Project is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of *Santalum Spicatum* Trees (Australian Sandalwood) 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 6 of this Ruling) who is accepted to participate in the 'forestry managed investment scheme' described at paragraphs 55 to 106 of this Ruling on or after 19 May 2010 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. Although not relevant for the purposes of Division 394, a Grower (as described in paragraphs 4 to 6 of this Ruling) who takes out insurance over the Trees on their Woodlot(s) per clause 22 of the Lease and Management Agreement and who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Such Growers who are individuals will be subject to the operation of Division 35 (see paragraphs 48 to 53 and 145 to 151 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 Growers who qualify as a 'small business entity' is not able to be dealt with in this Product 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 (referred to as the 'forestry manager' in Division 394). On the basis of that information, the Commissioner has decided that on 30 June 2010 it will be reasonable to expect that the '70% DFE rule'⁴ will be satisfied. The ATO 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 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.⁵ For this Project the Trees must be established before 31 December 2011.

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 600 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 ATO if the Trees are not established by 31 December 2011.

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

27. A Grower in the Project can claim deductions, on a **per Woodlot** basis, for the amounts shown in the Table below that are paid to the Responsible Entity (sections 8-5 and 394-10).

Fee	Amount	Income year(s) deductible (see Note)
Establishment and Ongoing Services Fee	\$4,290	2009-10
Rent	2.75% of the Gross Proceeds of Sale	Income year entitled to Gross Proceeds of Sale
Costs of Harvest and Processing	Actual costs	Income year entitled to Gross Proceeds of Sale
Selling and Marketing Fee	5.5% of the Gross Proceeds of Sale	Income year entitled to Gross Proceeds of Sale
Incentive Fee	13.75% of the Gross Proceeds of Sale, subject to achieving target yields	Income year entitled to Gross Proceeds of Sale

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

⁵ See subsection 394-10(4).

Note: the Responsible Entity will inform Growers of the income year in which fees set out in the Table above have been paid from proceeds and Growers are therefore entitled to claim deductions.

28. The deductibility of these amounts remains subject to a requirement that a CGT event⁶ does not happen in relation to the Grower's 'forestry interest' before 1 July 2014.

29. Each amount is deductible in the income year in which it is paid, or is paid on behalf of the Grower (subsection 394-10(2) and section 394-20). This requires cash to flow from the Grower, or from another entity on the Grower's behalf, to TFS Properties Ltd bank account in the year in which the deduction is claimed. Any form of payment that does not involve the movement of cash into TFS Properties Ltd bank account will not qualify for a deduction under subsection 394-10(2).

30. Where a Grower 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.

31. If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.

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

'CGT event' within four years for Growers who are 'initial participants'

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

33. A deduction for the Establishment and Ongoing Services Fee is not allowable where a 'CGT event' happens in relation to the 'forestry interest' of a Grower before 1 July 2014 (subsection 394-10(5)).

34. Where deductions for these amounts have already been claimed by a Grower, the Commissioner may amend their assessment at any time within two years of the 'CGT event' happening (subsection 394-10(6) of the ITAA 1997). The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936.

35. Growers 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'.

⁶ Defined in section 995-1.

Interest on loans to finance the 'forestry interest' of a Grower and insurance costs related to the 'forestry interest'

Section 8-1

36. A Grower in the Project can claim deductions for interest incurred on a loan to fund their investment in the Project (subsection 8-1(1)) in the income year in which the interest is incurred. This Product Ruling only applies to loans between a Grower and Arwon as described in paragraphs 97 to 105 of this Ruling. Growers 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.

37. Any amounts incurred by a Grower to insure their Trees will be deductible under section 8-1. Deductions for insurance premiums are allowable in the year in which the insurance costs are incurred. The Responsible Entity will advise the Grower each year of the cost of the insurance premiums.

38. This Product Ruling only applies if the insurance provided is on the same terms as described in the Forestry Insurance Policy provided with the application for a Product Ruling.

Borrowing costs

Section 25-25

39. For loans of \$5,000 and under from Arwon, the loan Application Fee is \$150. For loans over \$5,000, the Application Fee is \$300 plus 0.5% of the Principal Sum payable to Arwon.

40. The Application Fee payable and the stamp duty for the loan are borrowing expenses and are deductible under section 25-25.

41. 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.

42. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Arwon is outside the scope of this Product Ruling.

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

Sections 6-10, 394-25 and 17-5

43. Where a 'CGT event' happens to a 'forestry interest' held by a Grower 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 Grower (sections 6-10 and 394-25), less any GST payable on those proceeds (section 17-5).

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

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

Amounts received by Growers where sandalwood Seeds are sold or insurance proceeds are paid

Sections 6-5 and 17-5

46. Growers must include amounts received for the sale of sandalwood Seeds (referred to as Royalty Payments in the Product Disclosure Statement) 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).

47. Similarly insurance proceeds are assessable under section 6-5 in the year in which the amounts are derived less any GST payable on those proceeds (section 17-5).

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

Section 35-55 – annual exercise of Commissioner's discretion

48. If finance is not provided, for each of the income years from 2009-10 to 2014-15, the Commissioner will exercise the discretion in subsection 35-55(1) once the conditions at paragraph 50 of this Ruling are satisfied for the year concerned.

49. If finance is provided by Arwon, then for each of the income years listed in the table below for the relevant loan term, the Commissioner will exercise the discretion once the conditions at paragraph 50 of this Ruling are satisfied for the year concerned.

Arwon loan term	Period
1 to 7 years	2009-10 to 2014-15 (inclusive)
8 years	2009-10 to 2015-16 (inclusive)
9 years	2009-10 to 2017-17 (inclusive)
10 years	2009-10 to 2019-18 (inclusive)

50. Conditions that must be satisfied for each income year for the discretion to be exercised:

- the Grower carried on their business of afforestation during the income year; and
- the business activity that is carried on is not materially different to that in the scheme described in this Product Ruling; and
- the Grower has incurred a taxation loss for the income year from carrying on that business activity.

51. If these conditions are met for a given year, the Commissioner will exercise the discretion for that year under:

- paragraph 35-55(1)(b) for a Grower in the Project who satisfies the income requirement in subsection 35-10(2E); and
- paragraph 35-55(1)(c) for a Grower in the Project who does not satisfy the income requirement in subsection 35-10(2E).

52. If the Commissioner determines that the discretion will not be exercised for a particular year or years the Grower will be informed of that decision and the reasons. In any year where the discretion is not exercised, losses incurred by a Grower will be subject to the loss deferral rule in section 35-10 and the Grower will not be able to offset the losses from the Project against other assessable income.

53. The issue of this Product Ruling of itself does not constitute the exercise of the Commissioner's discretion in subsection 35-55(1) for any income year.

Prepayment and anti-avoidance provisions

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

54. Where a Grower is accepted to participate in the Project set out at paragraphs 55 to 106 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- interest paid by a Grower to Arwon and insurance costs do 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 Product Ruling.

Scheme

55. 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 documents provided on 12 February 2010, 17 February 2010, 18 February 2010, 3 March 2010, 20 April 2010, 3 May 2010 and 7 May 2010;
- Draft Product Disclosure Statement (PDS) for the TFS Spicatum Project 2010 issued by TFS Properties Ltd (Responsible Entity), received 18 February 2010;
- Draft **Constitution** for the TFS Spicatum Project 2010, received 20 April 2010;
- Draft **Lease and Management Agreement** between the Responsible Entity, TFS Leasing Pty Ltd (Lessor) and the Grower, received 12 February 2010;
- Draft **Agreement for Sub-Lease** between the Responsible Entity, TFS Leasing Pty Ltd and the Grower, received 12 February 2010;
- Draft Compliance Plan for the TFS Spicatum Project 2010, received 12 February 2010;
- Heads of Agreement between the Responsible Entity and WA Sandalwood Plantations Pty Ltd, received 12 February 2010;
- Draft Plantation Management Agreement between the Responsible Entity and WA Sandalwood Plantations Pty Ltd, received 17 February 2010;
- Draft Head Lease between the Responsible Entity, TFS Leasing Pty Ltd and the Security Holder, received 12 February 2010;
- Independent forestry report, dated 11 February 2010;
- Australian Financial Services Licence for the Responsible Entity, received 12 February 2010;
- Policy and Procedures for Arwon Finance Pty Ltd, received 20 February 2010;
- Draft **Finance Application** provided by Arwon Finance Pty Ltd, received 12 February 2010;
- Draft **Loan Agreement** between Arwon Finance Pty Ltd and the Borrower, received 12 February 2010;
- Multi Option Facility Agreement, Second Amendment and Restatement Deed and the Deed of Variation, received 12 February 2010;

- Draft Supply Agreement (Take-off Agreement) between the Responsible Entity and the Purchaser, received 18 February 2010; and
- **Forestry Insurance Policy** and Forestry Insurance Coverage Summary, received 20 February 2010.

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

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

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

Overview

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

Location	Central Wheatbelt region, Western Australia
Species of trees to be planted under the scheme	<i>Santalum Spicatum</i> (Australian Sandalwood)
Term of the Project	Approximately 20 years
Date all Trees are due to be planted on scheme land	31 December 2011
Number of Trees per hectare	Targeted survival rate of approximately 600 Trees per hectare
Number of hectares offered for cultivation	Approximately 1,000 hectares
Size of each 'forestry interest' (Woodlot)	0.25 hectares
Minimum allocation of 'forestry interests' per Grower	One forestry interest (Woodlot)
Minimum subscription	1,000 Woodlots (250 hectares)
Initial cost	\$4,290 per Woodlot
Ongoing costs and other costs	Rent; Costs of Harvest and Processing; Selling and Marketing Fees; Incentive Fee and insurance premiums

59. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. TFS Properties Ltd has been issued with an Australian Financial Service Licence 241192 and will be the Responsible Entity for the Project.

60. The Project involves establishing a *Santalum Spicatum* (Australian Sandalwood) plantation. Approximately 20 years after the Establishment Period the sandalwood will be harvested, processed and then sold.

61. Land is yet to be obtained for the Project, however suitable land has been identified in the Central Wheatbelt region of Western Australia.

62. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer pertains to approximately 4,000 Woodlots of 0.25 hectares each. There is a minimum subscription level of 1,000 Woodlots.

63. An entity that participates in the Project will do so by acquiring an interest in the project on or before 30 June 2010, which will consist of a minimum of one Woodlot.

64. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to execute, on behalf of the Grower, the Constitution, which includes the Lease and Management Agreement and any other documents required to hold an interest in the Project.

65. The Woodlots will be planted out with *Santalum Spicatum* seed at a sufficient density to achieve a final sandalwood stocking rate of 600 Australian Sandalwood trees per hectare.

66. *Santalum Spicatum* Seeds may be produced from the Trees. If a commercial quantity of the Seeds is produced, Growers may be entitled to part of the income generated from the sale of the Seeds.

67. Each Grower will use their Woodlot(s) for the purpose of carrying on a business of cultivating and harvesting *Santalum Spicatum* Trees and selling the harvested timber.

Constitution

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

69. In order to acquire an interest in the Project, the Grower must make an application for 'forestry interests' in accordance with clauses 11.2 and 11.3. Among other things, the Application has to be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the office of the Responsible Entity (or such other places as the Responsible Entity may nominate from time to time), and be accompanied by payment of the Application Money in a form acceptable to the Responsible Entity.

70. Under the terms of the Constitution, the Responsible Entity will create three separate funds, an Application Fund, a Maintenance Fund and a Proceeds Fund. Part of the Application Money will be paid into the Application Fund and part into the Maintenance Fund. The proceeds of the sale of Forest Produce will be paid into a Proceeds Fund (clause 2.5).

71. The Application Money will be released from the Application Fund and applied towards payment for the Establishment Services when the Responsible Entity is reasonably satisfied that the criteria specified in clause 13 of the Constitution have been met.

72. The Constitution also sets out provisions relating to:

- project property (clause 3);
- complaints handling (clause 5);
- winding up the Project (clause 6);
- distribution of the proceeds (clause 16);
- retirement and removal of the Responsible Entity (clause 25); and
- register of Growers (clause 26).

Compliance Plan

73. As required by the *Corporations Act 2001*, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease

74. The owner (the Responsible Entity or an unrelated entity) of the Project land will enter into a Head Lease with TFS Leasing Pty Ltd, as the Lessee, in respect of land required for the Project.

75. The Lessee must use the land only for the commercial silviculture of the Australian Sandalwood Trees (clause 5.1 and item 6 of the Schedule).

76. The Lessee will sub-lease the land to Growers in the Project. The sub-lease must be entered into in the form of a Lease and Management Agreement contained in the Schedule to the Constitution.

Lease and Management Agreement

77. Growers participating in the scheme will enter into a Lease and Management Agreement with TFS Leasing Pty Ltd, as the Lessor, and TFS Properties Ltd, as the Responsible Entity. Growers are granted an interest in the land in the form of a Lease to use their Woodlot(s) for the purposes of conducting their afforestation business. The Term of the Lease will be for a period of approximately 21 years commencing on the date on which the Grower's Application is accepted (Commencement Date) and ending when the final distribution of sale proceeds is made to the Grower or when the Project is terminated. Growers are specifically granted rights to harvest timber on their Woodlot(s) for this purpose. The Lease is granted upon the terms and conditions outlined in the Lease and Management Agreement.

78. Under the Lease and Management Agreement, each Grower appoints the Responsible Entity to perform the Services and the Responsible Entity accepts the appointment. The Responsible Entity will supervise and manage all silvicultural activity on behalf of the Grower in accordance with good silvicultural practice. Item 7 of the Schedule to the Lease and Management Agreement specifies the Establishment Services (item 7A) and Ongoing Services (item 7B) to be performed by the Responsible Entity.

79. The Establishment Services include:

- the acquisition of appropriate seeds and seedlings;
- carrying out weed control, surveying and ground preparation for each Woodlot;
- planting *Spicatum* seed on each Woodlot at a rate which would reasonably be expected to provide an average survival rate of 600 Trees per hectare;
- plant on the Woodlot host trees;
- cultivate, tend, cull, prune, fertilise, and spray, as required in support of planting; and
- use all reasonable measures to keep the Woodlot free of infestation from rabbits and other vermin.

80. The Ongoing Services include:

- cultivate, tend, cull, prune, fertilise, replant, spray, maintain and otherwise care for the Trees as and when required;
- plant on the relevant Woodlot such other Trees as it may be considered to be necessary to enable or encourage the growth of the *Spicatum* seedlings;
- replanting the relevant parts of the Plantation with sufficient seed or Trees if the Responsible Entity deems it necessary, with the replanting costs to be paid by the Responsible Entity;
- use of all reasonable measures to keep the Woodlot free of infestation from rabbits and other vermin;
- furnishing the Grower with reports as and when required;
- carry out, or arrange to be carried out, the Harvest and Processing of the Trees in a manner which maximises the return for the relevant Grower; and
- arrange for the sale of the Forest Produce.

81. The Responsible Entity may engage contractors to perform the Services. However, delegation by the Responsible Entity of any functions pursuant to the Lease and Management Agreement does not release it from liability under the agreement (clause 13).

82. The Lease and Management Agreement also provides for optional insurance cover against loss or damage to the Trees. If requested by the Grower, the Responsible Entity will endeavour to procure insurance cover against destruction or damage of the Grower's Woodlot(s) by fire and other usual risks (clause 22.1).

83. For the purpose of this Product Ruling only Growers who, from the time of planting until the end of the term of the Project, take out insurance in respect of the Trees against damage or destruction in terms of clause 22 of the Lease and Management Agreement for the Project, will be considered to be carrying on a business. Whether insurance is taken out or not will have no bearing on the deductibility under Division 394 of the amounts shown in the Table at paragraph 27 of this Ruling, the deductibility of interest shown at paragraph 36 of this Ruling and the deductibility of borrowing costs shown at paragraphs 39 to 42 of this Ruling.

Plantation Management Agreement

84. Under the Plantation Management Agreement, the Responsible Entity will engage a Manager, WA Sandalwood Plantations Pty Ltd, to establish the Growers' Woodlots and to manage and maintain the Woodlots on the terms and conditions contained in the Agreement.

85. The Manager will perform services including preparing the land and supplying and planting the sandalwood and host trees during the Establishment Period. After the Establishment Period the Manager will provide ongoing services including tending to the sandalwood and host trees in accordance with sound forestry and environmental practices.

Agreement for Sub-Lease

86. Where the Responsible Entity has not secured suitable land for the Project, it can still accept Growers into the Project under the Agreement for Sub-Lease. Under this Agreement, the Responsible Entity must secure suitable land and arrange for the Grower to enter into a Lease (the sub-lease of the Leased Area) with the Lessor in sufficient time for the Responsible Entity to perform the Establishment Services within the initial 18 month establishment period from the Commencement Date.

Pooling of Timber and Grower's Entitlement to Net Proceeds

87. The Trees will be harvested and processed in year 20. The Responsible Entity will Harvest and Process, or engage a suitably qualified person to Harvest and Process the percentage of Trees as set out in the Harvest Plan, unless the Responsible Entity believes that it would be in the best interests of the Growers to defer the Harvests to a later date.

88. The Responsible Entity is appointed to market and sell the Forest Produce, on behalf of the Growers who do not make an election under clause 15 of the Lease and Management Agreement (Non-Electing Growers), on such terms and conditions as the Responsible Entity considers appropriate (clause 17 of the Lease and Management Agreement).

89. The Constitution and the Lease and Management Agreement set out provisions relating to the pooling of Growers' timber and the distribution of proceeds from the sale of the timber (clause 16 of the Constitution and clause 18 of the Lease and Management Agreement).

90. The Responsible Entity must ensure that the Gross Proceeds of Sale are deposited into the Proceeds Fund (clause 18 of the Lease and Management Agreement). The Responsible Entity will pay any outstanding fees from the Proceeds Fund, with the remaining balance to be paid to the Grower in accordance with each Grower's Proportional Share.

Fees

Establishment and Ongoing Services Fee

91. The Establishment and Ongoing Services Fee payable to the Responsible Entity on application is \$4,290 per Woodlot (item 9A of the Schedule to the Lease and Management Agreement).

Other fees

92. The following amounts are payable to the Responsible Entity from the Project's proceeds:

- Rent equal to 2.75% of the Grower's Gross Proceeds of Sale (item 9C of the Schedule to the Lease and Management Agreement);
- Costs of Harvest and Processing payable from the Grower's Gross Proceeds of Sale (clause 18.2 of the Lease and Management Agreement);
- Selling and Marketing Fees equal to 5.5% of the Grower's Gross Proceeds of Sale (clause 18.2 of the Lease and Management Agreement); and
- an Incentive Fee equal to 13.75% of the Grower's Gross Proceeds of Sale, if the target yields specified in item 9B of the Schedule to the Lease and Management Agreement are achieved (item 9B of the Schedule to the Lease and Management Agreement).

Insurance

93. The Responsible Entity will insure the Plantation against fire until the end of the Establishment Period. Thereafter, if so requested, the Responsible Entity will arrange insurance of the Woodlot(s) on behalf of the Grower to cover the Woodlot(s) against fire and other usual risks. The cost of such insurance will be payable to the Responsible Entity by the Grower (clause 22 of the Lease and Management Agreement).

Finance

94. To finance all or part of the cost of their forestry interest a Grower can:

- apply for a '12 Months Interest Free Loan' with Arwon;
- enter into a Finance Application for a principal and interest loan with Arwon; or
- borrow from an independent lender external to the Project.

95. Only the finance arrangements set out below are covered by this Product Ruling. A Grower also cannot rely on this Product Ruling if they enter into a finance arrangement with Arwon that materially differs from that set out in the documentation provided with the application for this Product Ruling. A Grower who enters into a finance arrangement with a lender other than Arwon may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

96. A Grower cannot rely on any part of this Product Ruling if the Establishment and Ongoing Services Fee is not paid in full on or before 30 June 2010, by the Grower or, on the Grower's behalf, by a lending institution.

12 Months Interest Free Loan offered by Arwon

97. A Grower choosing to pay the Establishment and Ongoing Services Fee by entering into a 12 Month Interest Free Loan arrangement with Arwon must complete the application form attached to the PDS.

98. Growers who enter into such a Loan Agreement with Arwon are required to pay a deposit of 20% of the Establishment Fee and Ongoing Services Fee on Application.

99. The balance remaining after the 20% deposit is repayable in equal monthly instalments and must be paid within twelve months from the Application being accepted.

Principal and interest finance offered by Arwon

100. A Grower can finance the cost of their Establishment and Ongoing Services Fee by borrowing that amount from Arwon.

101. The Grower will be bound by the terms and conditions of the Loan Agreement entered into with Arwon.

102. The finance from Arwon is available as a principal and interest loan for a term of up to 10 years.

103. The following conditions apply to these loan arrangements:

- monthly repayments of principal and interest;
- interest payable as a fixed rate calculated by taking the cash rate as determined by the Reserve Bank of Australia, plus a margin of up to 9% per annum;
- for loans of \$5,000 and under an Application Fee of \$150. For loans over \$5,000, the Application Fee is \$300 plus 0.5% of the Principal Sum; and
- stamp duty, as applicable.

104. Arwon will only provide loans to Growers where it has sufficient funds to do so.

105. The loans from Arwon 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 Grower's interest(s) in the Project.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Arwon, are involved or become involved in the provision of finance to Growers for the Project.

Appendix 1 – Explanation

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

Structure of the Project

107. In return for payment of the Establishment and Ongoing Services Fee and the other fees and expenses required under the Project agreements during the term of the Project, Growers 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)).

Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Grower a right to a share in the proceeds of the harvest of the Trees grown on the Project land. That share of proceeds is determined using the number of 'forestry interests' held by a Grower as a proportion of all 'forestry interests' held by 'participants'⁷ in the Project.

Is the Grower carrying on a business?

108. 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?

109. 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).

110. Application of these principles to the arrangement set out above leads to the conclusion that Growers (as described in paragraphs 4 to 6 of this Ruling), who stay in the Project until its completion and who take out insurance over the Trees, will be carrying on a business of primary production.

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

Allowable deductions

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

111. 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

112. The threshold test for Growers 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 2010, 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

113. 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)).

114. 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)).

115. Both of the above amounts are determined as at 30 June 2010 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).

116. 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 2010.

⁸ See section 394-45.

⁹ See subsection 394-35(1) and section 394-40.

¹⁰ Defined in section 394-15(2).

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

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

118. The final requirement for deductibility requires all the Project Trees to be established within 18 months of 30 June 2010 (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 2011.

119. Accordingly, subject to the qualifications set out below, amounts paid by Growers 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)).

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

121. Where a Grower 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 subsection 394-10(1)

122. Two situations may lead to a loss of deductions previously allowed to Growers.

123. 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).

124. The second situation where a Grower 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 Project Application Money (see subsection 394-10(5)).

125. For the purposes of this provision, the Commissioner is able to amend the assessment of a Grower 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).

126. Where a 'CGT event' happens to the 'forestry interest' of a Grower 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 Grower 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 Grower and insurance costs related to the 'forestry interest'

Section 8-1

127. Where a Grower borrows the Application Money from Arwon to fund their investment in the Project, the deductibility of the interest incurred on the loan money falls for consideration under the general deduction provisions of section 8-1. Similarly, the costs relating to insuring the Trees fall for consideration under section 8-1. If the interest and the insurance costs incurred by the Grower are deductible under the first positive limb in subsection 8-1(1) there is no requirement to consider whether they are 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).

128. Under the first positive limb of subsection 8-1(1) the interest and insurance costs incurred by a Grower will be deductible if they are incurred in gaining or producing a Grower's assessable income and are 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).

129. Growers in the Project use the borrowed funds to acquire a 'forestry interest' in a 'forestry managed investment scheme' and the insurance costs protect their 'forestry interest' against certain risks. The holding of that 'forestry interest' will produce assessable income for a Grower in the form of the proceeds of a full or part disposal of the 'forestry interest' or, as a proportionate share of the harvest proceeds. The tests of deductibility of the interest and the insurance costs under the first limb of subsection 8-1(1) are, therefore, met unless one of the exclusions in subsection 8-1(2) apply.

130. 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, or insurance to protect, 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).

131. Therefore, the capital exclusion in subsection 8-1(2) does not apply to the interest and the insurance costs and subject only to the potential application of the prepayment provisions, a deduction for the interest can be claimed in the year in which they are incurred (Note: the meaning of 'incurred' is explained in Taxation Ruling TR 97/7).

Prepayment provisions

Sections 82KZL to 82KZMF

132. 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 section 82KZMD and section 82KZMF of the ITAA 1936.

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

134. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with Arwon and for insurance premiums will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Product Ruling applies (see paragraphs 100 to 105 of this Ruling) do not require any prepayment of interest over the term of the loan. Similarly, nothing provided with the application for this product Ruling indicated that insurance premiums will be prepaid. Accordingly, the prepayment provisions have no application to Growers who enter into those loans or incur expenses for insurance premiums.

135. However, if a Grower chooses to prepay the interest on their loans with Arwon or their insurance premiums, these amounts will not be covered by this Product Ruling and that Grower may request a private ruling on how the prepayment provisions will affect the timing of their deductions.

Borrowing costs

Section 25-25

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

137. In this Project the Application Fee payable to Arwon 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.

138. 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 Growers who are 'initial participants'

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

139. 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)

140. Where a 'CGT event' happens to a 'forestry interest' held by a Grower in this Project, subsection 394-25(2) includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted an amount under section 394-10; or
- the Grower would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 33 to 35 and 122 to 126 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to 'CGT events'

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

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

142. The market value amount included in the assessable income of a Grower is the value of the 'forestry interest' just before the 'CGT event', or where the Grower 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)).

143. 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.

Section 6-5 – Seed and insurance proceeds

144. The receipt of an amount arising from the sale of Seeds or the payment of insurance proceeds is a distribution that arises as an incident of the Grower holding a 'forestry interest' in the Project. It is an item of ordinary income and is assessable under section 6-5 in the income 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

145. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the 2009-10 income year who carries on a business of afforestation individually (alone or in partnership) is expected to incur losses from their participation in the Project which will be subject to Division 35.¹¹ These losses will be subject to the loss deferral rule in section 35-10 unless an exception applies or, for each income year in which losses are incurred, the Commissioner exercises the discretion in subsection 35-55(1) on 30 June of that specific income year.

¹¹ Division 35 does not apply to Growers who do not carry on a business or who carry on a business other than as individuals (alone or in partnership).

146. The exceptions to the loss deferral rule depend upon the circumstances of individual Growers and are outside the scope of this Product Ruling.

147. The Commissioner will apply the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner's discretion when exercising the discretion.

148. Where a Grower with income for Non-commercial Loss (NCL) purposes of less than \$250,000 (that is, the Grower satisfies the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(b) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will satisfy one of the four tests set out in Division 35 or produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and 35-10(2C)).

149. Where a Grower with income for NCL purposes of \$250,000 or more (that is, the Grower does not satisfy the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(c) is exercised for that year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not produce assessable income greater than the deductions attributable to it; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and 35-10(2C)).

150. A Grower will satisfy the income requirement in subsection 35-10(2E) where the sum of the following amounts is less than \$250,000:

- taxable income for that year (ignoring any loss arising from participation in the Project or any other business activity);
- total reportable fringe benefits for that year;

- reportable superannuation contributions for that year; and
- total net investment losses for that year.

151. In each individual year where the Commissioner's discretion is exercised a Grower within either paragraphs 148 or 149 of this Ruling who would otherwise be required to defer a loss arising from their participation in the Project under section 35-10 until a later income year is able to offset that loss against their other assessable income.

Section 82KL – recouped expenditure

152. 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 8-5 of the ITAA 1997.

Part IVA – general tax avoidance provisions

153. 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).

154. The Project will be a 'scheme' and a Grower will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraphs 27 to 42 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.

155. Growers 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 Growers 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 Growers will enter into the scheme for the dominant purpose of obtaining a tax benefit.

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- Subject references:*
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1-1YFEXLY
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ timber