



# ***PR 2010/5 - Income tax: Gunns Plantations Limited Woodlot Project 2010***

 This cover sheet is provided for information only. It does not form part of *PR 2010/5 - Income tax: Gunns Plantations Limited Woodlot Project 2010*

 This document has changed over time. This is a consolidated version of the ruling which was published on *17 March 2010*



## Product Ruling

### Income tax: Gunns Plantations Limited Woodlot 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**

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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**

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This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

## What this Ruling is about

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1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
2. In this Product Ruling, this scheme is referred to as the Gunns Plantations Limited Woodlot Project 2010 or simply as 'the Project'.

### 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. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Growers.
4. 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.
5. A Grower will have executed the relevant Project Agreements set out in paragraph 45 of this Ruling on or before 30 June 2010 and will hold a 'forestry interest' in the Project.
6. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities:
  - who are accepted into this Project before the date of this 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 adviserthat is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits or harvest returns) in any way;
  - whose Application Fee, including all loan moneys, is not paid in full to Gunns Plantations Ltd (GPL) by 30 June 2010, either by the Grower and/or on the Grower's behalf by a lending institution; or

- who enter into finance agreements with Gunns Finance Pty Ltd outside the terms specified in paragraphs 89 to 91 of this Ruling.

### **Superannuation Industry (Supervision) Act 1993**

7. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme 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 scheme may contravene the provisions of SISA.

### **Qualifications**

8. 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 45 to 92 of this Ruling.

9. 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

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11. This Product Ruling applies prospectively from 17 March 2010, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 17 March 2010 until 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 Project Constitution.

12. 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

13. 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.

14. 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

15. 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 Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

### Goods and Services Tax

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

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## Ruling

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### Structure of the Project

17. The Gunns Plantations Limited Woodlot Project 2010 is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of Eucalyptus trees for felling in Australia.

18. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for an 'initial participant'<sup>1</sup> in the defined class of entities (see paragraphs 3 to 6 of this Ruling) who is accepted to participate in the 'forestry managed investment scheme' described at paragraphs 45 to 92 of this Ruling between 17 March 2010 and 30 June 2010 inclusive.

19. An entity that takes part in the Project as a 'subsequent participant'<sup>2</sup> 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

20. Although not relevant for the purposes of Division 394, a Grower (as described in paragraphs 4 to 6 of this Ruling) who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Such Growers who are individuals will be subject to the operation of Division 35 (see paragraphs 40 to 43 of this Ruling).

### Concessions for 'small business entities'<sup>3</sup>

21. 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').

22. A 'small business entity' can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Because of these choices and the eligibility conditions the application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

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<sup>1</sup> See subsection 394-15(5).

<sup>2</sup> See section 394-30.

<sup>3</sup> 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)***

23. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by GPL. 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'<sup>4</sup> 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'.

24. The Ruling will only apply if GPL 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.<sup>5</sup> For this Project, the trees must be established before 31 December 2011.

25. 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 1,100 trees per hectare. GPL 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 2011.

## **Allowable deductions**

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

26. A Grower in the Project can claim deductions for the amounts shown in the Table below that are paid to GPL (sections 8-5 and 394-10). However, amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

27. The deductibility of these amounts remains subject to a requirement that a CGT event<sup>6</sup> does not happen in relation to the Grower's 'forestry interest' within four years of the Grower first paying an amount under the scheme (see paragraphs 30 to 32 of this Ruling).

28. The 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 GPL's bank account in the year in which the deduction is claimed. Any form of payment that does not involve the movement of cash into GPL's bank account will not qualify for a deduction under subsection 394-10(2).

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

<sup>5</sup> See subsection 394-10(4).

<sup>6</sup> Defined in section 995-1.

29. 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.

<b>Fee</b>	<b>Amount</b>	<b>Year(s) deductible</b>
Application fee	\$7,480 See Note (i)	2010
Rent	11% of Wood Sale Proceeds See Note (i)	Any year in which this amount is paid See Note (ii)
Maintenance fee	4.4% of Wood Sale Proceeds See Note (i)	Any year in which this amount is paid See Note (ii)
Sales commission	1.1% of Wood Sale Proceeds See Note (i)	Any year in which this amount is paid See Note (ii)

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Growers will be notified by GPL of the years in which these amounts are paid, but harvests are expected to occur in the years ending 30 June 2019 and 30 June 2023.

**'CGT event' within four years for Growers who are 'initial participants'*****Subsections 394-10(5) and (6)***

30. A deduction for the Application Fee is not allowable where a 'CGT event' happens in relation to the 'forestry interest' within four years of the Grower first paying an amount under the scheme (subsection 394-10(5)).

31. Where deductions for these amounts have already been claimed by a Grower, the Commissioner may amend their income tax return 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.

32. 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'.

## **Insurance Costs**

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

33. Insurance premiums are deductible under section 8-1 in the year in which they are incurred. Only insurance premiums payable to the named insurer under a policy that does not materially differ from the policy provided with the application for this Ruling are covered by this Product Ruling. GPL will advise the Grower each year of relevant amounts.

## **Borrowing costs**

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

34. The Loan Establishment Fee, payable to Gunns Finance Pty Ltd, of \$150 plus 0.4% of the loan amount, is a borrowing expense and is deductible under section 25-25. For loans with a term of less than five years, the deduction for the borrowing expense is spread over the period of the loan on a straight line basis from the date the loan begins.

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

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

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

36. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning<sup>7</sup> – see paragraph 39 of this Ruling) 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).

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<sup>7</sup> A thinning of the trees includes a selective harvest of immature trees to facilitate better outcomes at harvest. A thinning differs from a clear fell of a percentage of mature trees which may occur over two or more income years.

37. 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)).

38. '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 the Project trees are thinned or insurance proceeds received**

#### ***Section 6-5***

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

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

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

40. For each of the income years from 2009-2010 to 2021-2022, the Commissioner will exercise the discretion in subsection 35-55(1) once the following conditions are satisfied for the year concerned:

- 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 described in this Product Ruling; and
- the Grower has incurred a taxation loss for the income year from carrying on that business activity.

41. 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).

42. 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.

43. 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.

## Anti-avoidance provisions

### *Section 82KL and Part IVA*

44. Where a Grower is accepted to participate in the Project set out at paragraphs 45 to 92 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## Scheme

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

- Application for a Product Ruling as constituted by documents provided on 23 December 2009 and additional correspondence between GPL and the ATO received on 19 February 2010;
- Draft Product Disclosure Statement including the **Application and Power of Attorney Form** and the **Loan Application Form**, received 23 December 2009;

- Draft Constitution for the Gunns Plantations Limited Woodlot Project 2010, received 23 December 2009;
- Draft Compliance Plan for the Project, received 23 December 2009;
- Draft Land Interest Agreement between the owner of the Land (as Landowner) and GPL, received 23 December 2009;
- Draft **Sub-Land Interest Agreement** between GPL and the Grower, received 23 December 2009;
- Draft **Management Agreement** between GPL (as Manager) and Gunns Limited and the Grower, received 23 December 2009;
- Deed Poll by Gunns Limited in favour of the Growers, received 23 December 2009;
- Draft Establishment Services Sub-Contracting Agreement and Draft Maintenance Services Sub-Contracting Agreement, received 23 December 2009;
- Sample **Forestry Insurance Policy**, between GPL and a named insurance provider, received 19 February 2010;
- Draft Wood Sale Agreement received 23 December 2009; and
- Custody Agreement and Variation of Custody Agreement, both between GPL (as Trustee) and Gunns Limited (as Custodian), received 23 December 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.

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

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

**Overview**

48. The main features of the Gunns Plantations Limited Woodlot Project 2010 are as follows:

Location	Tasmania, southern Western Australia, and the 'Green Triangle' (located in a region of south eastern South Australia and south western Victoria)
Species of trees to be planted under the scheme	<i>Eucalyptus nitens</i> (Shining gum) or <i>Eucalyptus globulus</i> (Tasmanian Blue-gum)
Term of the Project	13 years
Date all trees are due to be planted on scheme land	31 December 2011
Number of trees per hectare	Approximately 1,100
Number of hectares offered for cultivation	5,000 hectares
Size of each 'forestry interest'	1 hectare
Minimum allocation of 'forestry interests' per Grower	one
Initial cost	\$7,480
Other costs	Growers will be charged for the cost of annual insurance against destruction or damage to the Growers Woodlot.  A fee for sales commission, rental and maintenance will be charged at the time of thinning (Year 9) and final harvest (Year 13). The fee will equal 16.5% of the 'Wood Sale Proceeds' from the 'Woodlot'.

49. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Gunns Plantations Limited has been issued with an Australian Financial Service Licence 238701 and will be the Responsible Entity for the Project.

50. The Project will involve the establishment and tending of *Eucalyptus* trees for felling in Australia.

51. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 5,000 hectares, which corresponds to 5,000 'forestry interests' in the Project.

52. An entity that participates in the Project as a Grower will do so by acquiring a 'forestry interest' in the Project on or before 30 June 2010, which will consist of a minimum of one 'forestry interest' of one hectare in size.

53. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints GPL to enter into, on behalf of the Grower, a Sub-Land Interest Agreement, a Management Agreement and any other documents required to hold an interest in the Project.

54. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and who execute the Sub-Land Interest Agreement and the Management Agreement on or before 30 June 2010 will become Growers in the 2010 Project.

55. The Responsible Entity has identified sufficient land to be used for the Project. Land will be secured in Tasmania, southern Western Australia, and the 'Green Triangle' (located in a region of south eastern South Australia and south western Victoria). Approximately 90% of the land is already under plantation and will need to be prepared for establishment again following a pending harvest. The remaining land is currently pasture, or used for other agricultural purposes, and needs to be converted and prepared for plantation establishment. Land utilised by the Project must meet the requirements set out by the Independent Forester as stated in the PDS.

56. This Land will be divided into one hectare lots and sub-leased to the Growers accepted in the Project.

### **Constitution**

57. The Constitution establishes the Project and operates as a deed binding all Growers and GPL. The Constitution sets out the terms and conditions under which GPL 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.

58. In order to acquire an interest in the Project, an entity must make an application for 'forestry interests' in accordance with clause 4. 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 3.4 of the Constitution, GPL holds the Application Money on bare trust and will deposit all Application Moneys received from applicants in a Project Account.

60. Once GPL has accepted the application and all of the Project Documents have been executed and remain in force (clause 7) the Application Money may be released and applied against the Application Fee due as payment of the Woodlot Establishment Expenses (clause 8).

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

- the general functions, powers and duties of the Responsible Entity (clause 12);
- complaints and dispute resolution (clause 13);
- transfer of Grower's interests (clause 17);
- distributions from the Fund (clause 29); and
- provisions relating to termination (clauses 33 and 34).

## **Compliance Plan**

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

## **Land Interest Agreement**

63. Each Landowner as the registered proprietor of the Land will grant GPL a Land Interest over the Land for the Term of the Project. Each Landowner and GPL will sign a Registration Instrument and any other document required to enable the Land Interest, or any rights established by the grant of the Land Interest, to be registered against the title or titles to the Land.

64. The Responsible Entity must only use the Land for establishing, planting, tending, maintaining and harvesting the trees and carrying out the Project.

65. The Responsible Entity may also sub-lease the land, or any part of the land, to Growers in the Project for a term equivalent to the term of the Land Interest.

## **Sub-Land Interest Agreement**

66. Each Grower will execute a Sub-Land Interest Agreement with the Responsible Entity as the Grantor. The Responsible Entity will grant to the Grower the right to carry out the Project's tree farming activities from the Commencement Date.

67. The Grower's and Grantor's rights and obligations are set out in clauses 4 and 5 of the Sub-Land Interest Agreement respectively. The Grower has, at all times, full right, title and interest in the trees and the right to have the trees sold for their benefit.

68. GPL is entitled to a Rental Fee that will be deducted from the Wood Sale Proceeds (clause 6).

### **Management Agreement**

69. Under the Management Agreement, GPL is appointed as Manager and will carry out Services, defined as Establishment Services and Maintenance Services, on behalf of each Grower.

70. The Establishment Services (clause 4) include, amongst other things:

- ploughing and cultivation required for the purposes of planting;
- procuring the supply of healthy Seedlings to an average density of 1,100 per hectare; and
- planting all Seedlings in accordance with good silvicultural practice.

71. The Manager must use its best endeavours to complete the Establishment Services within 18 months of the end of the financial year in which the Application Fee is paid by the first Grower accepted to participate in the scheme, that is, by 31 December 2011.

72. The Maintenance Services (clause 5) will be provided during the Term of the Sub-Land Interest Agreement. The Manager will replant any trees on a Grower's Woodlot that die for any cause during the first two years after the Commencement Date to maintain a minimum stocking level of 90% of the average initial planting density.

73. The frequency and timing of any pruning, Commercial Thinning, or Final Harvest is at the discretion of the Manager. In exercising its discretion, the Manager must have regard to good silvicultural practice, and, among other things, the objective of maximising returns to Growers.

74. Each Grower appoints GPL to act as their sole agent to market and sell the Wood on the Grower's behalf (clause 10.1). GPL will enter into a Wood Sale Agreement with a purchaser. A Draft Wood Sale Agreement is attached to the Management Agreement as Schedule 2.

75. If requested by the Grower, the Manager will endeavour to procure insurance cover against destruction or damage of the Grower's Woodlot by fire and other usual risks (clause 13.1).

76. The Manager will be responsible for insuring the Plantation against public risk for an amount of not less than \$20,000,000 during the Term of the Project (clause 13.3).

## **Sub-Contracting Agreements**

77. GPL will subcontract the management services under two separate agreements with Gunns Limited. The Establishment Services Sub-Contracting Agreement and the Maintenance Services Sub-Contracting Agreement require Gunns Limited to perform the services in accordance with the terms and conditions set out in the Management Agreement.

## **Pooling of Wood and Entitlement to Net Proceeds**

78. Clause 29 of the Constitution sets out the arrangements relating to the distribution of proceeds from the sale of the Wood. GPL will distribute the Wood Sale Proceeds among the Growers in accordance with each Grower's proportional interest in those proceeds.

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

- only Growers who have contributed Wood are entitled to benefit from distributions of Wood Sale Proceeds from the pool; and
- any pooled Wood must consist only of Wood contributed by all Pooled Growers in the Project.

## **Fees**

80. Under the terms of the Management Agreement and the Sub-Land Interest Agreement, a Grower will make payments as described below on a per 'forestry interest' basis.

81. The Project has an upfront Application Fee of \$7,480 which represents the total cost for establishment and planting of each Woodlot.

82. There are no ongoing maintenance fees or rent payable during the course of the Project. These costs, together with the Sales Commission payable to GPL, will be paid out of Wood Sale Proceeds from thinning in Year 9 and the clear-fell harvest in Year 13.

83. The fees to be paid out of Wood Sale Proceeds total 16.5% of Wood Sale Proceeds, consisting of Maintenance Fees of 4.4%, Rent of 11%, and Sales Commission of 1.1%.

84. Growers electing to insure their Woodlots (see paragraph 75 of this Ruling) will also be charged an administration charge of 11% of the amount of the premium for each year or part thereof.

85. No further fees are payable to GPL for this Project.

**Finance**

86. To finance all or part of the cost of their 'forestry interest' a Grower can enter into a finance arrangement with Gunns Finance Pty Ltd or borrow from an independent lender external to the Project.

87. Only the finance arrangement set out below is covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with Gunns Finance Pty Ltd 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 an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

88. A Grower cannot rely on any part of this Ruling if the Application 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. Payment in this context is explained in paragraph 28 of this Ruling.

***Finance offered by Gunns Finance Pty Ltd***

89. A Grower can finance the cost of their Application Fee by borrowing that amount from Gunns Finance Pty Ltd (as the Lender).

90. Subject to Gunns Finance Pty Ltd accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

91. Gunns Finance Pty Ltd is offering a 12 month interest free loan with the following features:

- Gunns Finance will take security over the Growers Woodlot;
- a loan Establishment Fee of \$150 plus 0.4% of the loan amount is added to the Loan amount;
- Growers who enter into this finance arrangement will be required to make equal monthly repayments over the Term of the Loan;
- monthly repayments are due as per Item 5 of the Loan Schedule and per the Woodlot Project Repayment Schedule and commence in July 2010; and
- there is no requirement that Growers must have insurance over their Woodlots.

## ***Other qualifications relating to finance***

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

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

## Appendix 1 – Explanation

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**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

93. In return for payment of the Application Fee and the other fees and expenses required under the Management Agreement and the Sub-Land Interest Agreement 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))

94. 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 thinning and 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'<sup>8</sup> in the Project.

### Is the Grower carrying on a business?

95. 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?

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

97. 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, will be carrying on a business of primary production involving afforestation activities.

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

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

98. 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. The list 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***

99. 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'<sup>9</sup> under the scheme will be no less than 70% of the amount of payments under the scheme.<sup>10</sup>

100. 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'<sup>11</sup> of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

101. 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)).

102. 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).

103. 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.

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<sup>9</sup> See section 394-45.

<sup>10</sup> See subsection 394-35(1) and section 394-40.

<sup>11</sup> Defined in section 394-15(2).

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

104. 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 is clear from the Project Agreements, as are the alternative elements of paragraph (e) relating to the number of Growers in the scheme and the Responsible Entity's role in other managed investment schemes.

105. 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 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.

106. Accordingly, subject to the qualifications set out below, amounts paid by Growers to the Responsible Entity in relation to 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)).

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

108. 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)***

109. Two situations may lead to a loss of deductions previously allowed to Growers under subsection 394-10(1).

110. 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 three months of the end of the 18 month period (section 394-10 of Schedule 1 to the TAA).

111. The second situation where a Grower may have deductions disallowed is where a 'CGT event' happens to their 'forestry interest' within four years from 30 June of the income year in which they paid an amount under the scheme, for example, the Application Fee (see subsection 394-10(5)).

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

113. Where a 'CGT event' happens to the 'forestry interest' of a Grower within four 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.

## **Insurance Costs**

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

114. Insurance premiums are deductible under section 8-1 in the year in which they are incurred. Only insurance premiums payable to the named insurer under a policy that does not materially differ from the policy provided with the application for this Ruling are covered by this Product Ruling. GPL will advise the Grower each year of relevant amounts.

## **Borrowing costs**

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

115. 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)).

116. In this Project, the Loan Establishment Fee is calculated as \$150 plus 0.4% of the loan amount. The Loan Establishment Fee is added to the loan amount and 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.

117. The deduction for the borrowing expense is spread over the period of the loan or five 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**

118. 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)**

119. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)<sup>12</sup> 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 30 to 32 and paragraphs 111 to 113 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

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

120. 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.

121. 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)).

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<sup>12</sup> A thinning under this scheme is not a 'CGT event'.

122. 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.

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

### **Section 6-5**

123. 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)).

124. Thinning amounts or insurance proceeds received by a Grower 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 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 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**

125. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the year ended 30 June 2010 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.<sup>13</sup> 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.

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

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

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<sup>13</sup> 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).

128. Where a Grower with income for non-commercial loss 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 (2C).

129. Where a Grower with income for non-commercial loss 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 (2C).

130. 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.

131. In each individual year where the Commissioner's discretion is exercised a Grower within either paragraph 128 or paragraph 129 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**

132. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

## **Part IVA – general tax avoidance provisions**

133. 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).

134. The Gunns Plantations Limited Woodlot Project 2010 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 26 to 35 of this Ruling, above 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.

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

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

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### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 97/11; TR 98/22; TR 2007/6

### *Subject references:*

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

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