



PR 2011/17 - Income tax: Australian Oak Project - 2012 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 October 2011*



Product Ruling

Income tax: Australian Oak Project – 2012 Growers

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❶ This publication provides you with the following level of protection:
This publication (excluding appendixes) is a public ruling for the purposes of the Taxation Administration Act 1953.

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

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Product Ruling this scheme is referred to as the scheme, the Australian Oak Project, or simply as 'the Project'.
2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Product Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Product Ruling, terms defined in the Project agreements have been capitalised.

Class of entities

3. This part of the Product Ruling specifies which entities;
 - are subject to the taxation obligations; and
 - can rely on the taxation benefits;

set out in the Ruling section of this Product Ruling.

4. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to in this Product Ruling as Growers.
5. Growers are those entities that are accepted to take part in the scheme specified below on or after the date this Product Ruling is made.
6. A Grower will have executed the relevant Project Agreements set out in paragraph 33 on or before 31 December 2011 and will hold a Timber Lot 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 Ruling or after 31 December 2011;
 - entities who participate in the scheme through offers made other than through the Australian Oak Project 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;

- entities who intend to terminate their involvement in the arrangement prior to its completion or otherwise do not intend to derive assessable income from it; and
- entities who elect to take their own Produce under the Lease and Management Agreement ('Electing Growers').

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 32 to 63 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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Superannuation Industry (Supervision) Act 1993

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

Date of effect

12. This Product Ruling applies prospectively from 19 October 2011, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 19 October 2011 until 31 December 2011, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2014 being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme entered into during the period of application.

13. However this 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 participants are fully informed of any legislative changes after this Product Ruling is issued.

Goods and Services Tax

17. All fees and expenditure referred to in this Product Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 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

Application of this Ruling

18. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 32 to 63 of this Product Ruling.

19. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Lease and Management Agreement.

Carrying on a business

20. A Grower (as described in paragraphs 4 to 6) who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Provided the Project is carried out as described below, the Growers business of primary production will commence at the time of execution of their Lease and Management Agreement. Such Growers who are individuals will be subject to the operation of Division 35 of the ITAA 1997 (see paragraphs 27 to 30).

Concessions for 'small business entities'¹

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 Product Ruling, other than as specified.

Assessable income

Sections 6-5

23. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

¹ The meaning of 'small business entity' is explained in section 328-110

Application Fee***Part 3-1 of the ITAA 1997 and Division 6 of Part III of the ITAA 1936***

24. Growers will acquire Timber Lots in the Project. The Timber Lots are CGT Assets (section 108-5) and the Application Fee of \$2,292.95 payable per Timber Lot in the Project constitutes an outgoing of capital and is not allowable as a deduction under section 8-1.

25. The amount paid for each Timber Lot will represent the first element of the cost base of the Timber Lots (subsection 110-25(2)). Any disposal of the Timber Lots by the Grower will be a CGT Event and may give rise to a capital gain or loss.

Deductions for Annual Fees, Rent Fees and Insurance Fees***Section 8-1***

26. A Grower may claim tax deductions for the following fees and expenses on a per Timber Lot basis, as set out in the Table below.

Fee Type	Year ending 30 June 2012	Year ending 30 June 2013	Year ending 30 June 2014
Annual Fee	See Note (i), (ii) & (iv)	\$363.72* See Note (i) & (ii)	\$363.72* See Note (i) & (ii)
Rent Fee	See Note (i), (ii) & (iii)	\$225.92* See Note (i) & (ii)	\$225.92* See Note (i) & (ii)

* These amounts are subject to indexation from 1 July annually commencing on 1 July 2012 as per the Lease and Management Agreement.

- (a) 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
- (b) Subject to note (iii) the Annual Fee and Rent Fee are deductible under section 8-1 in the income year that the relevant fee is incurred.
- (c) The deduction for the Rent Fee for the year ending 30 June 2012 is \$225.92 multiplied by the number of days from the date you are accepted into the scheme to 30 June 2012 divided by 365.
- (d) The deduction for the Annual Fee for the year ended 30 June 2012 is \$363.72 multiplied by the number of days from the date you are accepted into the scheme to 30 June 2012 divided by 365.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – annual exercise of Commissioner’s discretion during the period beginning with the 2011-12 income year and concluding with the 2020-21 income year***

27. For each of the income years from 2011-2012 to 2020-21, 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 forestry 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.

28. 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).

29. 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.

30. 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 provisions and anti-avoidance provisions***Sections 82KZM, 82KZME, 82KZMF, 82KL and Part IVA of the ITAA 1936***

31. Where a Grower is accepted to participate in the Project set out at paragraphs 32 to 63, the following provisions of the ITAA 1936 have application as indicated:

- Annual Fees and Rent Fees paid by a Grower does not fall within the scope of sections 82KZM, 82KZME and 82KZMF;

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

Scheme

Continuing application of PR 2005/51 and PR 2005/52

32. Although now withdrawn, the tax benefits set out in PR 2005/51 and PR 2005/52 continue to apply to Growers who are within the specified class of entities to which the Product Ruling applied. This is subject to there being no material difference in the scheme or in the entities involved in the scheme. This Ruling applies to investors who acquire existing Timber Lots within the scheme.

33. 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 received on 17 May 2011, 25 May 2011 and 13 June 2011;
- Australian Oak Project Product Disclosure Statement dated 7 October 2011 and received on 3 October 2011;
- Constitution of Timber Lakes (WA) Limited dated 20 January 2005 and received on 17 May 2011;
- **Lease and Management Agreement** between Timber Lakes as Manager/Lessor and each Grower, received on 3 October 2011;
- The Australian Oak Project Compliance Plan, received on 17 May 2011;
- Constitution of the Australian Oak Project dated February 2005, registered with ASIC on 27 April 2005 and received on 17 May 2011; and
- Correspondence received on 13 June 2011 providing additional information.

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

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

35. 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

36. The main features of the Australia Oak Project are as follows:

Location	Lot 4, Plan 13763 (known as Blue Lake) and 2 Plan 13763 (known as Whitfield Springs) Brand Highway, Gingin, Western Australia
Species of trees to be planted under the scheme	River She-oak (species name <i>Casuarina Cunninghamiana</i>)
Term of the Project	10 years
Number of trees per hectare	650 trees
Number of hectares offered for cultivation	26 hectares
Size of each 'forestry interest'	0.35 hectares
Minimum allocation of 'forestry interests' per Grower	1 Timber Lot
Minimum subscription	1 Timber Lot
Initial cost	\$2,292.95
Ongoing Annual and Rent Fee	\$363.72 Annual Fee \$225.92 Rent Fee These amounts are indexed from 1 July annually commencing on 1 July 2012.
Other costs	Incentive Fee: The amount by which the net proceeds from the sale of timber exceeds \$50,176 (GST exclusive) per Timber Lot. Insurance Fee Harvest Fee: 3% of the amount of gross proceeds from harvesting.

37. The Project is a registered managed investment scheme under the *Corporations Act 2001* (Australian Registered Scheme Number 114 039 593). Timber Lakes (WA) Limited has been issued with an Australian Financial Service Licence 285611 and will be the Responsible Entity for the Project.

38. The Project will involve 74 Timber Lots which are 0.35 hectares in size (approximately 26 hectares), containing approximately 227 River She-oak trees per Timber Lot.

39. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 26 hectares, which corresponds to 74 'forestry interests' in the Project.

40. An entity that participates in the Project as a Grower will do so by acquiring a Timber Lot in the Project on or before 31 December 2011, which will consist of a minimum of one Timber Lot per Grower being 0.35 hectares in size.

41. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Timber Lakes to enter into, on behalf of the Grower, a Lease and Management Agreement and any other documents required to hold an interest in the Project.

42. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and who execute the Lease and Management Agreement on or before 31 December 2011 will become Growers in the 2012 Project.

43. The Responsible Entity is currently leasing Land for the Project within Gingin Western Australia.

Constitution

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

45. In order to acquire an interest in the Project, an entity must make an application for a Timber Lot in accordance with clause 11.1. 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.

46. Under clause 2.5 of the Constitution, Timber Lakes holds the Application Money on bare trust. Timber Lakes will deposit all Application Moneys received from applicants in a Project Account (clause 12).

47. Once Timber Lakes has accepted the application and all of the Project Documents have been executed and remain in force (clause 11) the Application Money may be transferred and applied against the fees due to Timber Lakes (clause 15).

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

- the identification of the Project (clause 2);
- the holding of the Project Property (clause 3);
- complaints handling (clause 5);
- the winding up of the Project (clause 6);
- the fees and expenses payable to the Responsible Entity (clause 7);
- entering into the Lease and Management Agreement (clause 11);
- the release of application moneys (clause 15);
- the general powers and duties of the Responsible Entity (clause 17);
- the transfer of Grower's interests (clause 21);
- the keeping of a register of Growers (clause 26); and
- dispute resolution (clause 30).

Compliance Plan

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

Interest in Land

50. The Lease and Management Agreement commences on the date the Agreement is executed. The Responsible Entity grants a Lease to the Grower under the terms of the Lease and Management Agreement. The Agreement is terminated pursuant to the provisions of the Agreement or on the date of completion of the Project (Item 6 of Schedule).

51. Growers are granted an interest in land in the form of a Lease to occupy their Timber Lot for the purpose of growing, maintaining, cultivating and harvesting River She-oak trees. Growers have full right, title and interest in the collectable produce (clause 19.1 of the Lease and Management Agreement). Growers must pay Rent Fees to the Responsible Entity.

Lease and Management Agreement

52. Each Grower enters into a Lease and Management Agreement with the Responsible Entity. The term of the Project is from the date of execution of this agreement until the earlier of the date the harvest of the trees is completed, the termination of the Grower's interest under the Agreement or such later date as determined by the Responsible Entity having regard to sound silvicultural practices.

53. Grower's contract with the Responsible Entity to establish, maintain and manage the Grower's Timber Lot and perform the harvest, processing and sale of the Collectable Produce from the Grower's Timber Lot. Growers must pay an Application Fee upon application. An Annual Fee is payable on or before 30 September each year after the First Period being from 1 July 2011 to 30 June 2012.

54. Rent Fees will be incurred annually and will commence from the 1 July 2012 and the amount is paid annually on 30 September of the financial year to which the Rent Fee relates. Rent is indexed from 1 July in the first Period (clause 4.1).

55. The Grower will engage the Responsible Entity to provide the following services:

- Carry out weed control of the Leased Area in connection with the Trees;
- Cultivate, tend, cull, prune, fertilise, spray, maintain and otherwise care for the Trees as and when required;
- Keep in good repair an access road or roads to Leased Area;
- Use all reasonable measures by fumigating and poisoning for exterminating and keeping the Lease Area free from rabbits and other vermin and to comply with the provisions of all statutes regulations and by laws and all amendments thereto with respect to the same and any other statutes rules regulations and by laws relating to or affecting the Leased Area of the Grower in respect thereof;
- Maintain in good repair and condition adequate fire-breaks in and about the Leased Area;
- Maintain the Leased Area according to good silvicultural and forestry practices;
- Furnish to the relevant Grower reports as and when required by this Lease and Management Agreement and the Constitution;

- 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
- Maintain in good repair and condition access to the Timber Lot.

Pooling of Timber and Entitlement to Net Proceeds

56. The Management Agreement sets out provisions relating to the Grower's entitlement to harvest proceeds. Within 5 Business Days of making the payments referred to in clause 20.2 the Manager shall pay from the Net Proceeds of Sale:

- Any outstanding Rent Fee to the Lessor;
- Fees to the Manager pursuant to clause 23;
- Any other amounts owed to the Manager or the Lessor pursuant to the terms of the Management Agreement or the Constitution; and
- Distribute to the Non-Electing Growers the remainder

Fees

57. Under the terms of the Lease and Management Agreement, a Grower will make payments as described below on a per Timber Lot basis.

Fees payable under the Management Agreement

58. The Initial Cost is to be paid by each Grower on application for the provision of the forestry interest in the Application Period. The Initial Cost comprises of the Acquisition Fee, Annual Fees and Rent Fees. Annual Fees, Rent Fees and Insurance Fees will be apportioned on a monthly basis if the Grower is accepted into the scheme on or after 1 August 2011.

59. Following the Application Year, ongoing Annual Fees are payable to the Responsible Entity for providing the services identified in paragraph 55.

60. The Responsible Entity will also be entitled to 3% of the gross harvest proceeds and an Incentive Fee payable in consideration for the Manager achieving returns pursuant to clause 23 of the Lease and Management Agreement, by which the net proceeds from the sale of timber exceeds \$50,176 (GST exclusive) per Timber Lot.

Fees payable under the Sub-lease (or Licence)

61. For the Term of the Project Rent of \$225.92 per 'forestry interest' per annum is payable on or before 30 September of the financial year to which the Rent relates. This amount is indexed from 1 July annually commencing on 1 July 2012.

Finance

62. There is no financing facility offered by the Manager or any other party to the arrangement. Growers can fund their investment in the Project themselves, or borrow from an independent lender. Growers cannot rely on any part of this Ruling if the Initial Costs are not paid in full on or before 31 December 2011. Where the Initial Costs are being financed through a lending institution written evidence of approval must be provided to Timber Lakes by the lending institution on or before 31 December 2011. The lending institution must provide the full amount of the loan monies to Timber Lakes no later than 31 December 2011.

63. 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
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Appendix 1 – Explanation

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

Is the Grower carrying on a business?

64. For the amount set out in paragraph 26 to constitute allowable deductions the Grower's afforestation activities as a participant in the Australian Oak Project must amount to the carrying on of a business of primary production.

65. 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?*

66. 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).

67. Application of these principles to the arrangement set out above leads to the conclusion that Growers (as described in paragraphs 4 to 6), who stay in the Project until its completion, will be carrying on a business of primary production involving growing and harvesting River She-oak trees for sale.

Acquisition Fee

68. Any part of the expenditure of a Grower entering into a business attributable to acquiring an asset or advantage of an enduring kind, is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the Commissioner is of the view that the Acquisition Fee relates to the acquisition of the right to harvest and sell standing timber and is properly characterised as capital expenditure. Therefore, the Acquisition Fee of \$2,292.95 will be on a capital account in the hands of the Grower and not deductible under section 8-1.

Deductions for Annual Fees, Rent Fees and Insurance Fees

Section 8-1

69. The Rent, Annual and Insurance Fees are deductible under section 8-1. A non-income producing purpose is not identifiable in the arrangement and there is no capital component evident in the Annual, Rent or Insurance Fees.

70. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Provided that the prepayment provisions do not apply (see paragraphs 71 to 72 below) a deduction for these amounts 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 of the ITAA 1936

71. 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. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

72. For this Project, the only prepayment provisions that are relevant are sections 82KZL of the ITAA 1936 (an interpretative provision) and sections 82KZME and section 82KZMF of the ITAA 1936 (operative provisions).

Deferral of losses from non-commercial business activities and the Commissioner's discretion

Sections 35-10 and 35-55

73. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the year ended 30 June 2012 who carries on a business of [forestry] individually (alone or in partnership) is expected to incur losses from their participation in the Project which will be subject to Division 35.² 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.

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

75. 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.

² 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).

76. Where a Grower with income for NCL purposes of less than \$250,000 (i.e., 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 forestry 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).

77. Where a Grower with income for NCL purposes of \$250,000 or more (i.e., 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 [forestry] 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).

78. 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.

79. In each individual year where the Commissioner's discretion is exercised a Grower within either paragraph 76 or paragraph 77 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.

Recouped expenditure

Section 82KL of the ITAA 1936

80. 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.

General tax avoidance provisions

Part IVA of the ITAA 1936

81. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C of the ITAA 1936) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D of the ITAA 1936).

82. The Australian Oak 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 paragraph 26 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.

83. 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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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2007/6

Subject references:

- 4 year holding period
- carrying on a business
- forestry interest
- forestry MIS
- interest expenses
- managed investment schemes
- payments under the scheme
- producing assessable income
- product rulings
- reasonable expectation
- tax avoidance
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C

- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 318
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(2)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 17-5
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- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(2C)
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- ITAA 1997 35-55
- ITAA 1997 35-55(1)
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- Hance v FC of T; Hannebery v FC of T [2008] FCAFC 196; 2008 ATC 20-085; (2008) 74 ATR 644

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