

PR 2011/9A1 - Addendum - Income tax: TFS Sandalwood Project 2011

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Addendum

Product Ruling

Income tax: TFS Sandalwood Project 2011

This Addendum amends Product Ruling PR 2011/9 to include principle and interest finance of up to 10 years provided by Arwon Finance Pty Ltd.

PR 2011/9 is amended as follows:

1. Paragraph 28

- (a) Omit last row from the Table.
- (a) Omit Notes (ii) and (iii).

2. Paragraph 32

After the paragraph insert:

**Interest on Loans to finance 'forestry interest' and
borrowing costs**

Sections 8-1 and 25-25

32A. A Grower may claim tax deductions for the following fees and expenses set out in the following table.

| Fee | Amount | Year(s) deductible |
|--|--|---|
| Interest payable to Arwon | As determined by the loan agreement | 30 June in the year in which the interest is incurred See note (i) |
| Borrowing Costs for Principle and Interest Loan with Arwon | \$300 plus 0.5% of the loan amount | See note (ii) |
| Borrowing Costs for 12 month interest fee loan with Arwon | \$100 Administration fee per applicant | 2010-2011 income year See note (ii) |

Notes

- (i) Interest payable for loans with Arwon Finance Pty Ltd (Arwon) is deductible in the year in which it is incurred. However, the deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Arwon is outside the scope of this Ruling. Growers who borrow from lenders other than Arwon or who choose to prepay their interest may request a private ruling on the deductibility of the interest incurred or may self assess the deductibility of the interest incurred.
- (ii) The Borrowing Costs payable to Arwon is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing money that is used or is to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or over five years, whichever is shorter. Where the Borrowing Cost is \$100 or less, the whole of the borrowing expense is deductible in the year in which it is incurred. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Arwon is outside the scope of this Ruling.

3. Paragraph 46

Omit the first dot point; substitute:

- Application for a Product Ruling as constituted by documents provided on 13 December 2010, 6 January 2011, 27 January 2011, 8 February 2011, 15 February 2011, 21 February 2011, 22 February 2011, 23 February 2011, 2 March 2011, 18 March 2011, 28 April 2011, 29 April 2011, 5 May 2011 and 17 May 2011;

After eighth dot point; insert:

- Draft TFS Sandalwood Project 2011 **Finance Application** and Draft Arwon **Loan Agreement**, received 18 May 2011;

4. Paragraph 86

Omit the dot points; substitute:

- apply for a '12 Months Interest Free Loan' with Arwon;
- apply for a 'Principle and Interest Loan' with Arwon; or
- borrow from an independent lender external to the Project.

5. Paragraph 93

After the paragraph, insert:

Principle and Interest Loan offered by Arwon

93A. A Grower choosing to pay the Establishment Fee by entering into a principal and interest loan with Arwon for up to 10 years must complete the application form attached to the PDS.

93B. Growers who enter into such agreement will be bound by the terms and conditions of the loan agreement.

93C. The loan agreement offered by Arwon requires:

- monthly payments of principle and interest;
- an application fee of \$300 plus 0.5% of the amount of the finance;
- a deposit of 10% may be payable;
- to be secured by a charge over the Growers interests in the Project.

93D. The finance provided by Arwon is made on a full recourse commercial basis and normal debt recovery procedures, including legal action will be taken in the case of defaulting borrowers.

93E. Arwon will only provide loans to Growers where it has sufficient funds to do so.

6. Paragraph 116

After the paragraph, insert:

Interest on loans to finance the 'forestry interest' of a Grower**Section 8-1**

116A. Where a Grower borrows money to fund their investment in the Project the deductibility of the interest incurred on the loan monies falls for consideration under the general deduction provisions of section 8-1. If the interest incurred by the Grower is deductible under the first positive limb in subsection 8-1(1) there is no requirement to consider whether it is also deductible under the second positive limb of that provision. Court decisions show that the same basic test applies to both limbs (see *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431, at CLR 56; ATD 435).

116B. Under the first positive limb of subsection 8-1(1) the interest incurred by a Grower will be deductible if it is incurred in gaining or producing a Grower's assessable income and is not excluded by one of the negative limbs in subsection 8-1(2).

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

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

[T]he characterisation of interest will generally be ascertained by reference to the objective circumstances of the use to which the borrowed funds are put' (*Federal Commissioner of Taxation v. Roberts* (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494, at FCR 257; ATC 4388; ATR 504).

116C. Growers in the Project use the borrowed funds to acquire a 'forestry interest' in a 'forestry managed investment scheme'. The holding of that 'forestry interest' will produce assessable income for a Grower in the form of the proceeds of a full or part disposal of the 'forestry interest' or, as a proportionate share of the harvest proceeds. The tests of deductibility of interest under the first limb of subsection 8-1(1) are, therefore, met unless one of the exclusions in subsection 8-1(2) apply.

116D. For the purposes of this Project, only the capital exclusion in paragraph 8-1(2)(a) is relevant. The use of borrowed funds to purchase a capital asset, such as a 'forestry interest', does not mean that the interest outgoings are on capital account (see *Steele v. Federal Commissioner of Taxation* (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139, at CLR 470; ATC 4249; ATR 148).

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

116E. Therefore, the capital exclusion in subsection 8-1(2) does not apply to the interest and, subject only to the potential application of the prepayment provisions, a deduction for the interest can be claimed in the year in which it is incurred. (Note: the meaning of 'incurred' is explained in Taxation Ruling TR 97/7.)

7. Paragraph 118

After the paragraph, insert:

118A. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with Arwon will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Ruling applies (see paragraphs 86 to 93E of this Ruling) do not require any prepayment of interest over the term of the loan. Accordingly, the prepayment provisions have no application to Growers who enter into those loans.

118B. If a Grower chooses to prepay interest on these loans that Grower may request a private ruling on how the prepayment provisions will affect the timing of their interest deduction.

8. Paragraph 120

Omit Paragraph 120; substitute:

120. In this Project the Borrowing Costs payable to Arwon is incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

9. Paragraph 121

Omit Paragraph 121; substitute:

121. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the amount exceeds \$100, the deduction for the borrowing expense is spread over the period of the loan or 5 years, whichever is the shorter (subsection 25-25(4)).

10. Paragraph 139

Insert:

| | |
|--|-----|
| Interest on Loans to finance 'forestry interest' and borrowing costs | 32A |
| <i>Sections 8-1 and 25-25</i> | 32A |
| Principle and Interest Loan offered by Anwon | 93A |

| | |
|---|------|
| Interest on loans to finance the 'forestry interest' of a Grower | 116A |
| <i>Section 8-1</i> | 116A |

11. Legislative References

Insert:

- ITAA 1997 25-25(4)

12. Case references:

Insert:

- *Ronpibon Tin NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431, at CLR 56; ATD 435
- *Fletcher & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613, at CLR 17; ATC 4957; ATR 621
- *Federal Commissioner of Taxation v. Roberts* (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494, at FCR 257; ATC 4388; ATR 504
- *Steele v. Federal Commissioner of Taxation* (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139, at CLR 470; ATC 4249; ATR 148
- *Australian National Hotels Ltd v. Federal Commissioner of Taxation* (1988); 19 FCR 234; 88 ATC 4627; (1988) 19 ATR 1575, at FCR 241; ATC 4633-4634; ATR 1582

Commissioner of Taxation

15 June 2011

ATO references

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