



PR 1998/3 - Income tax: Great Southern Blue Gum Project No 2 Prospectus No 5

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 This document has changed over time. This is a consolidated version of the ruling which was published on *9 December 1998*



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Income tax: Great Southern Blue Gum Project
No 2 Prospectus No 5

other Rulings on this topic

PR 98/1; TR 92/1;
TR 97/11; TR 97/20;
TD 93/34

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Preamble

*The number, subject heading, and the **What this Product Ruling is about**, **Tax laws**, **Class of persons**, **Date of effect**, **Withdrawal**, **Arrangement** and **Rulings** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law' identified below applies to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Great Southern Blue Gum Project No 2 Prospectus No 5, or just simply as 'the Project', or the 'product'.

Tax law

2. The tax law dealt with in this Ruling is section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997'). The operation of sections 82KL and 82KZM and Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936') is also dealt with (see the **Explanations** section).

Class of persons

3. The class of persons to whom this Ruling applies are those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as a result (as set out in the description of the arrangement). In this Ruling these persons are referred to as 'Growers'.

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4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 25) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

9. This Ruling applies prospectively from 9 December 1998, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 1999. The Ruling continues to apply, in respect of the tax law ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents.

- Prospectus issued by Hampton Securities Australia Limited, Prospectus No 5, dated 5 November 1997
- **Lease and Management Agreement** between Great Southern Managers Limited ('GSML') and Perpetual Trustees W.A. Limited ('PTL') and the Grower
- Trust Deed between Great Southern Managers Limited and Perpetual Trustees W.A. Limited, dated 21 January 1993
- **Application for Finance**, Principal & Interest Loans Only
- **Loan Agreement** between Templegate Finance Pty Ltd, and the Borrower
- Letter from PriceWaterhouseCoopers dated 24 September 1998
- 'Plantation Management Agreement (1999 Plantings)' between Great Southern Managers Limited as trustee of the Great Southern Blue Gum Trust No. 1 and Great

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Southern Plantations Pty Ltd ('GSP') as trustee for the Great Southern Plantations Trust

- Letter from PriceWaterhouseCoopers dated 6 October 1998, including Supplementary Prospectus, and Second Supplementary Prospectus.

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

13. The documents highlighted are those that Growers enter into. The effect of these agreements is summarised as follows.

14. This arrangement is called the Great Southern Blue Gum Project No 2. Growers entering into the Project will sublease land from GSML in either the South West of Western Australia, in an area known as the 'Great Southern', or land within a 150km radius of the Port of Portland in Victoria, in an area known as the 'Green Triangle Region'. The Growers will also enter into a Management Agreement with GSML to have *eucalyptus globulus* (Blue Gums) planted on this leased land for the purpose of eventual felling and sale in approximately eleven years.

15. There are 2,000 Leased Areas on offer of 0.36 hectares each at a cost of \$3,000 per Leased Area. The total land area for the Project is 720 hectares although GSML has the right to accept over subscriptions. A minimum of 1,000 trees per hectare will be planted in the first 13 months following execution of the Lease and Management Agreement. Possible projected returns for Growers are outlined on pages 22 and 23 of the Prospectus. The projected returns depend on a range of assumptions and GSML does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into Lease and Management Agreements being offered pursuant to the Prospectus. Based on the examples set out on pages 22 and 23 of the Prospectus, a Grower could expect to achieve compound after tax returns of between 6.7% and 14.6%.

Lease and Management Agreement

16. Under the Lease and Management Agreement, Growers enter into an 11 year lease for one or more Leased Areas and contract with GSML to establish and maintain the plantation until maturity. Clause 2 grants an interest in the land to the Grower. Certificates are

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issued to Growers. GSML keeps a register of Growers. Growers are not entitled to assign the Lease and Management Agreement except in certain circumstances (cl 7). Growers execute a power of attorney enabling GSML to act on their behalf as required (cl 30). Growers may elect to collect their own timber produce (cl 18) or GSML, acting as agent, will sell the timber produce or process it into woodchips and then sell, on the Grower's behalf, for the best possible commercial price (cl 19). Non-Electing Growers will accept the Gross Proceeds of Sale in full satisfaction and discharge of Growers' rights in relation to the forest produce (cl 20).

Fees

17. The total fees payable under the Lease and Management Agreement are \$3,000. However, this includes a \$150 commission charge, which is not claimed to be an allowable deduction. Forecast expenditure on page 22 of the Prospectus indicates that of the \$3,000 the 'Manager's profit' is expected to be \$411.

18. The Independent Forester has stated, at page 32 of the Prospectus, that 'the activities described in the Lease and Management Agreements are normal to plantation forestry operations. The price per Leased Area adequately covers costs associated with the satisfactory establishment and maintenance...'.

19. PTL will hold the application price in the trust for the 'Great Southern Blue Gum Project'. The application price will be released to GSML when PTL is satisfied that certain specified criteria have been met (cls 22, 8.9).

20. After the first 13 month period GSML will pay for the Project's ongoing costs, other than insurance premiums payable by the Grower (cl 23). In return GSML will receive 2.5% of the net harvest proceeds for remuneration and 2.5% of the net harvest proceeds for rental costs of the Leased Area. GSML is required to lodge with PTL cash or bank backed securities for an amount to be determined by PTL on the advice of the Independent Forester. This will ensure that sufficient reserve funds will be available, if needed, to meet ongoing maintenance costs.

Planting

21. During the first 13 month period GSML will be responsible for planting *eucalyptus globulus* on the Leased Area. From this period on GSML will maintain the trees in accordance with good silvicultural practice. The services to be provided by GSML over the term of the Project are outlined in Item 10 of the Schedule to the Agreement. GSML will also be responsible for the establishment and maintenance

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of access roads and fire breaks, and is required to keep the Leased Area free from vermin. Finally, GSML will be responsible for arranging the marketing and sale of either the timber produce or woodchips. When the m³/ha in the Forest equals or exceeds 250m³/ha, or no later than 11 years from the Commencement Date, GSML will arrange for harvesting and will notify an Electing Grower when and where to collect produce and what the Grower's proportional shares of the costs of felling will be (cl 17). GSML will provide ongoing reports to the Growers on the progress of the plantations. GSML will sub-contract all plantation establishment and maintenance functions to Great Southern Plantations Pty Ltd (GSP), a related company.

22. The Gross Proceeds of Sale of the timber will be paid to PTL. The Grower's proportional share of the costs of felling and costs of sale and, if applicable, the costs of chipping will be deducted from the Gross Proceeds of Sale and be paid to GSML or the relevant contractor within 24 hours of receipt of the money by PTL. PTL will pay 2.5% of the Net Proceeds of Sale as rent and another 2.5% as remuneration to GSML. In addition, an amount of 0.5% will be paid as remuneration to PTL. The balance of the Net Proceeds of Sale will be held in the Proceeds Fund on trust for the Growers (cl 21).

Finance

23. Where Growers choose to enter into finance arrangements with Templegate Finance Pty Ltd, a company associated with GSML and GSP, two finance options are offered:

- Option A interest free
- 10% deposit (e.g., \$300/leased area)
 - 12 equal monthly instalments (\$225 pm) by periodical debit for each leased area
- Option B principal and interest
- 10% deposit (with a minimum loan principal under this option of \$20,000)
 - 48 monthly repayments
 - interest rate currently 12.5% fixed
 - Security by mortgage over the Lease and Management Agreement.

24. Under both options GSML is to be put in funds by the financier as and when the monthly repayments are made by the Grower. Both

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options involve full recourse loans and Templegate Finance Pty Ltd will pursue legal action against outstanding borrowers.

Ruling

25. For the year ended 30 June 1999 section 8-1 of the *Income Tax Assessment Act 1997* will apply to Growers entering into this Project as follows:

- i. of the Lease and Management fee of \$3,000 per leased area incurred by a Grower on execution of the Lease and Management Agreement on or before 30 June 1999, \$2,850 will be an allowable deduction; and
- ii. where a Grower borrows funds in order to fund their obligation to pay the lease and management fees, and incurs interest on such borrowings on or before 30 June 1999, that interest will be an allowable deduction.

Explanations

Section 8-1

26. Consideration of whether Lease and Management fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

27. An afforestation scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the timber's sale from the scheme will constitute gross assessable income in their own right. The generation of

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'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

28. Generally, an investor will be carrying on a business of afforestation where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the timber;
- the afforestation activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

29. For this Project Growers have, under the Lease and Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Lease and Management Agreement Growers appoint GSML, as Manager, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the Trees. Growers control their investment. The specific cost of these services provided in the first thirteen months, together with the initial cost of leasing the land, will total \$2,850. Growers may either collect the forest produce and arrange for its sale or they have the option of GSML arranging marketing and sale for a proportion of the proceeds.

30. The Lease and Management Agreement gives Growers more than a chattel interest in the timber on harvest. The Project documentation contemplates Growers will have an ongoing interest in the growing trees - the trees are the Growers' property and Growers have a legal interest in the land being the lease itself.

31. Growers have the right to use the land in question for afforestation purposes and to have GSML come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over GSML as evidenced by the Agreements, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on GSML's activities. Growers are able to terminate arrangements with GSML in certain instances, such as cases of default

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or neglect. The afforestation activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

32. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The Independent Forester's report is that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

33. Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

34. Growers have a continuing interest in the trees from the time they are acquired until harvest. The afforestation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' afforestation activities will constitute the carrying on of a business.

35. The fees associated with the afforestation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of timber), is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Section 82KZM

36. Under the Lease and Management Agreement the fee of \$2,850 per Leased Area will be incurred on execution of that Agreement. This fee is charged for providing services to a Grower only for the period of 13 months from the execution of the Agreement. For this Ruling's purposes no explicit conclusion can be drawn from the arrangement's description, that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question.

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Thus, for the purposes of this Ruling it can be accepted that no part of the fee of \$2,850 is for GSML doing 'things' that are not to be wholly done within 13 months of the fee of \$2,850 being incurred. On this basis the basic precondition for section 82KZM's operation is not satisfied and it will not apply to the expenditure by Growers of \$2,850 per Leased Area.

Section 82KL

37. Section 82KL's operation depends, amongst other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by Templegate Finance Pty Ltd to the Grower. The loan is provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

38. For Part IVA 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). The Great Southern Blue Gum Project No 2 will be a 'scheme'. It commenced generally on 19 November 1997 when the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount of \$2,850 per Leased Area, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

39. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. Further, there are no features of the Project, for example, such as the Lease and Management fee of \$2,850 being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

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Interest deductibility

40. As the majority of the fees are paid up front, little further expenditure will be incurred after 30 June 1999 in respect of this Project under the Lease and Management Agreement, until the sale of the timber. However, some Growers intend to finance the investment through a loan facility. Whether the interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the Lease and Management fees of \$2,850 per Leased Area to be incurred in the year ended June 1999 will be deductible. The interest fees incurred in the year ended 30 June 1999 will be in respect of a loan to finance the operations - the tending, maintenance and harvesting of the trees, and the lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. These fees will thus, also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Commissioner of Taxation

9 December 1998

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- ITAA97 8-1

case references