


PR 2000/80 - Income tax: ITC Hardwood Timber Project 2000 - Supplementary Prospectus

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 This document has changed over time. This is a consolidated version of the ruling which was published on *21 June 2000*



Product Ruling

Income tax: ITC Hardwood Timber Project 2000 - Supplementary Prospectus

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 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.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give 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 investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the 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 Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply 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 'ITC Hardwood Timber Project 2000 - Supplementary Prospectus', or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM (ITAA 1936);
- section 82KZMA (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 82KZMC (ITAA 1936);
- section 82KZMD (ITAA 1936); and
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant law(s) are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding

information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. The class of persons to whom this Ruling applies is 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 set out in the description of the arrangement. In this Ruling these persons are referred to as ‘Growers’.

7. 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

8. The Commissioner rules on the precise arrangement identified in this Ruling.

9. 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

11. This Ruling applies prospectively from 21 June 2000, the date the 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).

12. 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, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) 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.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2000/53, which is withdrawn on and from the date this Ruling is made. Product Ruling 2000/53 will continue to apply to investors who entered into the Project on or before 21 June 2000.

Arrangement

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

- Application for Product Ruling dated 14 February 2000 and 9 June 2000;
- Draft ITC Hardwood Timber Project 2000 Prospectus, undated, issued by ITC Project Management Limited (ITCPM);
- Draft Supplementary Prospectus, dated 16 June 2000;
- Draft ITC Hardwood Timber Project 2000 Constitution executed by ITCPM, undated.
- Draft Compliance Plan for the Project executed by ITCPM as the Responsible Entity, undated;

- **Draft Lease between ITCPM and the Grower;**
- **Draft Forest Right between ITCPM and the Grower;**
- **Draft Management Agreement between ITCPM (the ‘Manager’) and the Grower.**
- Draft pre-payment loan Application between ITC Finance Pty Ltd and the Grower.
- Additional correspondence dated 14 February 2000, 23 February 2000, 31 March 2000, 10 April 2000 and 9 June 2000.

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

16. The documents highlighted are those the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to, with the exception of finance agreements, to which paragraph 42 applies. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is ‘ITC Hardwood Timber Project 2000 - Supplementary Prospectus’.

| Unit of investment | Plantation Unit |
|-----------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Locations | <ul style="list-style-type: none"> • south west and southern coastal regions of Western Australia; and • sub-tropical region of central Queensland |
| Type of business each participant (Grower) is carrying on | Commercial growing, and cultivation of Tasmanian blue gum (<i>E. globulus</i>) in Western Australia or flooded gum (<i>E. grandis</i>) and river red gum, a flooded gum hybrid, (<i>E. grandis</i> x <i>E. camaldulensis</i>) in Queensland for the purpose of producing timber for woodchipping, saw logs, veneer logs and any other suitable product. |
| Number of hectares under | 1,500 |

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| | |
|-------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| cultivation | |
| Name used to describe the product | ITC Hardwood Timber Project 2000 - Supplementary Prospectus |
| Size of each Plantation Unit | 1 hectare |
| Number of trees per hectare | 800 |
| Expected production @ Year 8 | Pulpwood 152 m ³ /hectare |
| Expected production @ Year 18 | <ul style="list-style-type: none"> • Pulpwood 106 m³/hectare • Saw Logs 176 m³/hectare • Veneer Logs 70 m³/hectare |
| Term of the investment in years | Approximately 18 |
| Initial cost per hectare (for a minimum subscription of three (3) Plantation Units) | \$4,200 |
| Ongoing costs (for a minimum subscription of three (3) Plantation Units) | <ul style="list-style-type: none"> • Management: \$217 per Plantation Unit (indexed after the first (1st) year); and • Lease: \$250 per Plantation Unit (indexed). |

18. Growers who apply on or before 28 June 2000 will have their application processed and agreements and leases executed by 30 June 2000. Agreements and leases will not be executed prior to 30 June 2000 where applications are received after the 28 June 2000.

19. Growers will execute a Power of Attorney enabling ITCPM as the Project Manager to act on their behalf as required when they make an application for Plantation Units. Growers applying under the Draft Prospectus enter into a Lease or Forest Right and a Management Agreement with ITCPM (the Project Manager). The lease/forest right gives a Grower a lease/forest right from ITCPM, over an identifiable area of land called a 'Plantation Unit' until the trees are harvested and sold, and net income distributed.

20. The Project Land is situated in two locations:

- south west and southern coastal regions of Western Australia, and
- sub-tropical region of central Queensland.

21. ITC estimates that approximately 75% of the land will be owned by ITC Timberlands Limited and the remainder will be leased.

22. ITC Timberlands Limited will either lease the properties or grant a Forest Right to ITCPM. ITCPM will then sublease or grant a Forest Right for the same land (as Plantation Units) to the Grower to carry on the Grower's business.

23. There is no minimum subscription for this Project. The Prospectus states that 1,000 hectares of land in Western Australia and 500 hectares of land in Queensland have been selected and further land may be acquired for planting if needed. Each investor is required to subscribe for a minimum of three (3) Plantation Units of one hectare each in any combination of areas, at a cost of \$3,000 per Plantation unit plus a fixed fee of \$3,000. The expected yield from each Plantation Unit is 504 cubic metres of timber as follows:

| | Pulpwood | Saw Logs | Veneer Logs |
|------------------------|--------------------|--------------------|--------------------|
| Year 8 (thinning) | 152 m ³ | | |
| Year 18 (clearfell) | 106 m ³ | 176 m ³ | 70 m ³ |

The plantations are expected to qualify as "Kyoto Forests" and any sale of carbon credits will be sold for the benefit of the Growers (Draft Prospectus page 16). Trees will be planted during winter in Western Australia and during summer in Queensland.

24. Possible projected returns for Growers are outlined on pages 7 - 9 of the Draft Prospectus. The projected returns depend on a range of assumptions and the Project Manager does not give any assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with, entering into the Project. Based on the table set out on page 7 of the Draft Prospectus, a Grower could expect to achieve after tax returns in the range of 8.3% to 12.4% depending on the location and the number of Plantation Units purchased.

Constitution

25. The Constitution establishes the responsibilities of ITCPM as the Responsible Entity. It sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity:

- ensures that Application Funds are not released until appropriate agreements etc are in place (cl 8);
- prepares the Management Agreement & lease documents (cl 6);
- distributes the profits (cl 30); and
- keeps a register of Growers (cl 27).

Compliance Plan

26. The Project Manager has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Project Manager meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in Land

27. A Lease, or a Forest Right for the Queensland project, is granted by the Responsible Entity to the Grower under the terms of the Lease or Forest Right (cl 2). Growers are granted an interest in land in the form of a Lease or a Forest Right to use the said land for the purpose of conducting their afforestation business (cl 3). Growers can choose to either pre-pay the lease fees for the term of the project (18 years) with the Primary Services Fee or annually. Growers who choose to pay annually must pay the grantor of the Lease or Forest Right a fee of \$250 per Plantation Unit per annum (cl 7) commencing 31 December 2000. This fee is indexed annually. The term of an annual payer's Lease or Forest Right is up to the date the trees on the Plantation Units have been harvested and sold and the Responsible Entity pays the proceeds into the Proceeds Fund. Growers that pre-pay, pay an amount of \$4,500 (\$250 x 18) per Plantation Unit together with the Primary Services Fee on application. In certain circumstances Growers are entitled to assign their Lease or Forest Right (cl 13).

Management Agreement

28. A Management Agreement is entered into between the Responsible Entity and the Grower for each Plantation Unit. The termination of the Project is after completion of the harvest of all plantations comprising the Project (item 4 of schedule 1).

29. Growers contract with the Responsible Entity to establish and maintain the plantation until maturity. Growers pay the Management Fees for the term of the Project. The initial Management Fee is \$3,000 per Plantation Unit plus a fixed fee of \$3,000 for plantation

preparation and establishment costs including the provision of Management Plan and seedlings (item 1 of schedules 2 & 3). The fee for planting is \$200 for each Plantation Unit payable on the 31 December 2000 (item 2 of schedule 3). The annual Management fee per Plantation Unit is \$150 (indexed after the first payment) plus a fixed fee of \$200 commencing 31 December 2000 for the year ended 30 June 2001 (item 3 of schedule 3). Growers who choose to pre-pay the Planting and Management fees will pay \$200 per Plantation Unit for planting, \$3,600 (\$200 x 18) for the fixed component of the Management Fee and \$2,700 (\$150 x 18) per Plantation Unit for Management Fees. These pre-paid amounts will be paid together with the Primary Services Fee on application.

30. The Responsible Entity will purchase and plant *Eucalyptus globulus* trees in Western Australia and *Eucalyptus grandis* and *Eucalyptus grandis* x *Eucalyptus camaldulensis* hybrid trees in Queensland. It will also cultivate, maintain, replant, fertilise, water, prune, tend, maintain and otherwise care for the Plantation Unit as and when required according to good silvicultural and forestry practices to produce mature trees suitable for woodchipping.

31. The Responsible Entity guarantees that if the Grower invests in the Project by 28 June 2000 and providing that land is available for investment the Primary Services consisting of the preparation of a Management Plan, obtaining all necessary approvals, purchase of seedlings, supervision & management of work and administration (item 1 of schedule 2 to the Management Agreement) will be provided by 30 June 2000 (Draft Prospectus page 2).

32. The Responsible Entity will harvest and sell the timber produce on the Growers' behalf (item 4 of schedule 2). The Grower may elect to market and arrange for the sale of the Tree Crop (cl 9). The Responsible Entity will arrange insurance for the Growers at their request and cost (item 3(t) of schedule 2).

33. The Responsible Entity may be removed from its appointment by an ordinary resolution of Growers if the Growers take action under Division 1 of Part 2G.4 of the Corporations law if the Responsible Entity:

- is in breach of the Management Agreement and has not remedied the breach(cl 6); or
- has retired or is removed as the Responsible Entity (cl 6).

Fees

34. Growers have the option of either paying fees annually or on application, pre-paying the Planting Fee for the work to be done by

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30 June 2001, and pre-paying the Management & Lease fees for 18 years. A summary of the fees payable, exclusive of any GST that may be applicable, under clause 5 of the Management Agreement is:

Pre-payment option not taken

| | Year 1 | Year 2 | Year 3 |
|----------------------------------------|---------------|---------------|-----------------|
| Primary Services – fixed fee | \$ 3,000 | | |
| Primary Services – per Plantation Unit | \$ 3,000 | | |
| Planting – per Plantation Unit | | \$ 200 | |
| Management Fee – fixed amount | | \$ 200 | \$200 |
| Management Fee – per Plantation Unit | | \$ 150 | \$150 (indexed) |
| Total for three (3) Plantation Units | \$12,000 | \$1,250 | \$650 |

Pre-payment option

| | Year 1 | Year 2 | Year 3 |
|----------------------------------------|---------------|---------------|---------------|
| Primary Services – fixed fee | \$3,000 | | |
| Primary Services – per Plantation Unit | \$3,000 | | |
| Planting – per Plantation Unit | \$200 | | |
| Management Fee – fixed amount | \$3,600 | | |
| Management Fee – per Plantation Unit | \$2,700 | | |
| Lease Fee – per Plantation Unit | \$4,500 | | |
| Total for three (3) Plantation Units | \$37,800 | Nil | Nil |

35. The initial primary Services fee of \$3,000 per Plantation Unit plus a fixed fee of \$3,000 is for the preparation of a Management Plan for the Plantation Units, obtaining all necessary approvals, purchase of seedlings, supervision & management of work and administration (item 1 of schedule 2 to the Management Agreement). These initial fees are payable upon application to the Project.

36. The Planting Services fee of \$200 per Plantation Unit is for planting and supervision and management of the seedlings. These amounts are due and payable on 31 December 2000 or on execution of the Management Agreement if later than 31 December 2000 (item 2 of schedule 3 to the Management Agreement). Where the pre-payment option is taken this fee is payable upon application to the Project.

37. The annual Management Fee is \$150 per Plantation Unit plus a fixed amount of \$200 commencing 31 December 2000 for the year ended 30 June 2001. For annual payers the \$150 amount will be increased yearly after the first payment by the percentage increase in the Consumer Price Index Australia from the immediately preceding year (item 3 of schedule 3 to the Management Agreement). The Management Fee is in respect of the management of the crop including fertilisation, weed & pest control, fire control, arranging insurance (when requested), inspection and preparation of reports. Where the pre-payment option is taken the Management Fee for 18 years is payable upon application to the Project.

38. The Independent Forester has stated in its report that "The claims made in the Prospectus and in supporting documents concerning growth rates are based on a mixture of actual experience and professional judgement and appear achievable on a Project level, provided the same high level of management applied to their existing estate is applied to the Project" (p 33 of the Draft Prospectus).

39. The Application Monies will be banked in the Application Bank Account formed under the Project's Constitution (cl 3.3(b) of the Constitution). Upon acceptance of an Application the Responsible Entity shall release the relevant application monies from the Application Fund trust bank account and apply them in payment of the fees under the Management Agreement in respect of the Primary Services of the Management Agreement (cl 9 of the Constitution).

Planting

40. *Eucalyptus globulus* trees will be planted in winter in the south west and southern coastal regions of Western Australia and *Eucalyptus grandis* and *Eucalyptus grandis* x *Eucalyptus camaldulensis* hybrid trees will be planted in summer in the sub-tropical region of central Queensland. After planting the Responsible Entity will maintain the trees in accordance with good silvicultural

practice. The services to be provided by the Responsible Entity over the Project's term are outlined in the Management Agreement (cl 3). Unless the Grower elects to market and arrange for the sale of the Tree Crop (cl 9) the Responsible Entity will be responsible for arranging the marketing and sale of the timber produce (cl 3). The Responsible Entity is entitled to a Harvest Fee of 5% of the Harvest Proceeds (item 4 of schedule 3 to the Management Agreement).

41. The proceeds of sale of the timber produce will be banked in the Proceeds Fund bank account formed under the Project's Constitution (cl 3.3(c)). Proceeds received by the Responsible Entity are to be distributed to the Grower after deductions for:

- any amount due under a Management or Land Right agreement; and
- any other amounts of tax or duty which is payable by the Responsible Entity on behalf of the Grower (cl 31.1 of the Constitution).

Finance

42. Growers investing in the Project may either fund their investment personally, arrange finance themselves or, subject to satisfying certain criteria, use a financing facility provided by ITC Finance Pty Ltd (ITCF), an associate of ITCPM. It is proposed that ITCF will borrow funds from a bank, and possibly ITC, and on-lend these funds to Growers who request finance. The term of the loan will be for 18 years from 30 June 2000. All funding will be on a full recourse basis.

43. The terms of the ITC pre-payment loan offered by ITCF is for 18 years. Interest is 9% for the first 8 years then 11% per annum, interest free to 30 June 2000. Repayments are interest only for the first payment on 30 September 2000, 1/11th of the principal on 31 October 2000, 31 quarterly interest payments commencing on 31 December 2000 followed by 40 quarterly principal & interest repayments. Security for the loan will be the interest in the Plantation Units and borrowers must provide ITCF with authority to debit their bank account for repayments. Interest payments made under an ITC pre-payment loan is not considered to have any pre-payment element attached.

44. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;

- entities associated with the Project, other than ITC Finance Pty Ltd, are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Goods and Services Tax

45. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Allowable Deductions

46. For a Grower who invests in the Project, the deduction available for the fees will depend upon the date that the investment is made, whether the fees are pre-paid and, in some cases, whether or not they are 'small business taxpayers'. The tables below set out the range of deductions available.

IMPORTANT: Paragraphs 47 to 51 (relating to 'small business taxpayers') and paragraphs 52 to 56 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to

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carefully examine the information contained in paragraphs 57 and 58 relating to proposed changes to the pre-payment rules.

Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

Small Business Taxpayers

Growers who are ‘small business taxpayers’ and choose not to pre-pay lease, planting and management fees.

47. For such a Grower who invests in the Project on or before 28 June 2000 and chooses not to pre-pay fees, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

Deductions available each year exclusive of GST

| Fee Type | ITAA 1997 Section | Year 1 30/6/2000 | Year 2 30/6/2001 | Year 3 30/6/2002 |
|----------------------------------------|----------------------------------|-----------------------------|-----------------------------|-----------------------------|
| Primary Services – fixed fee | 8-1 | \$ 3,000 | | |
| Primary Services – per Plantation Unit | 8-1 | \$ 3,000 | | |
| Planting – per Plantation Unit | 8-1 | | \$ 200 | |
| Management Fee – fixed amount | 8-1 | | \$ 200 | \$ 200 |
| Management Fee – per Plantation Unit | 8-1 | | \$ 150 | \$ 150 (indexed) |
| Lease Fee – per Plantation Unit | 8-1 | | \$ 250 | \$ 250 (indexed) |
| Interest on ITCF Pre-payment Loan | 8-1 | * | * | * |
| Total for three (3) Plantation Units | | \$12,000 | \$2,000 | \$1,400 |

* Details of the amount of interest incurred must be obtained from the credit provider.

48. For a 'small business taxpayer' Grower who invests in the Project after 28 June 2000 and chooses not to pre-pay fees the following deductions will be available for the years ended 30 June 2001 and 30 June 2002:

Deductions available each year exclusive of GST

| Fee Type | ITAA 1997 Section | Year 1 30/6/2000 | Year 2 30/6/2001 | Year 3 30/6/2002 |
|----------------------------------------|----------------------------------|-----------------------------|-----------------------------|-----------------------------|
| Primary Services – fixed fee | 8-1 | | \$ 3,000 | |
| Primary Services – per Plantation Unit | 8-1 | | \$ 3,000 | |
| Planting – per Plantation Unit | 8-1 | | \$ 200 | |
| Management Fee – fixed amount | 8-1 | | \$ 200 | \$ 200 |
| Management Fee – per Plantation Unit | 8-1 | | \$ 150 | \$ 150 (indexed) |
| Lease Fee – per Plantation Unit | 8-1 | | \$ 250 | \$ 250 (indexed) |
| Interest on ITCF Pre-payment Loan | 8-1 | | * | * |
| Total for three (3) Plantation Units | | | \$14,000 | \$1,400 |

* Details of the amount of interest incurred must be obtained from the credit provider.

49. For a 'small business taxpayer' Grower who invests in the Project and chooses not to pre-pay fees the following provisions of the ITAA 1936 have application as indicated:

- (i) the expenditure by the Growers does not fall within the scope of section 82KZM;

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- (ii) the expenditure by the Growers does not fall within the scope of sections 82KZMB-82KZMD;
- (iii) section 82KL does not apply to deny the deductions otherwise allowable; and
- (iv) 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.

Growers who are ‘small business taxpayers’ and choose to pre-pay lease, planting and management fees.

50. For a Grower who is a ‘small business taxpayer’ who invests in the project on or before 28 June 2000 and pre-pays the Lease, Planting and Management fees the deductions shown in the table below will be available for the years ended 30 June 2000 to 30 June 2002:

Deductions available each year exclusive of GST

| Fee Type | ITAA 1997 Section | Year 1 30/6/2000 | Year 2 30/6/2001 | Year 3 30/6/2002 |
|----------------------------------------|----------------------------------|-----------------------------|-----------------------------|-----------------------------|
| Primary Services – fixed fee | 8-1 | \$3,000 | | |
| Primary Services – per Plantation Unit | 8-1 | \$ 3,000 | | |
| Planting – per Plantation Unit | 8-1 | \$ 200 | | |
| Management Fee – fixed amount | 8-1 & 82KZM Note (i) | | \$ 360 | \$ 360 |
| Management Fee – per Plantation Unit | 8-1 & 82KZM Note (i) | | \$ 270 | \$ 270 |
| Lease Fee – per Plantation Unit | 8-1 & 82KZM Note (i) | | \$ 450 | \$ 450 |
| Interest on ITCF Pre-payment Loan | 8-1 | Refer Note (ii) | Refer Note (ii) | Refer Note (ii) |
| Total for three (3) Plantation Units | | \$12,600 | \$2,520 | \$2,520 |

(i) Section 82KZM applies as the pre-payment is for >13 months and the eligible service period commences on 1 July 2000; and

(ii) Details of the amount of interest incurred must be obtained from the credit provider.

51. For a Grower who is a ‘small business taxpayer’ who invests in the project after 28 June 2000 and pre-pays the Lease, Planting and Management fees the deductions shown in the table below will be available for the years ended 30 June 2001 to 30 June 2002:

PR 2000/80**Deductions available each year exclusive of GST**

| Fee Type | ITAA 1997 Section | Year 1 30/6/2000 | Year 2 30/6/2001 | Year 3 30/6/2002 |
|----------------------------------------|----------------------------------|-----------------------------|-----------------------------|-----------------------------|
| Primary Services – fixed fee | 8-1 | | \$ 3,000 | |
| Primary Services – per Plantation Unit | 8-1 | | \$ 3,000 | |
| Planting – per Plantation Unit | 8-1 | | \$ 200 | |
| Management Fee – fixed amount | 8-1 & 82KZM Note (i) | | \$ 360 | \$ 360 |
| Management Fee – per Plantation Unit | 8-1 & 82KZM Note (i) | | \$ 270 | \$ 270 |
| Lease Fee – per Plantation Unit | 8-1 & 82KZM Note (i) | | \$ 450 | \$ 450 |
| Interest on ITCF Pre-payment Loan | 8-1 | Refer Note (ii) | Refer Note (ii) | Refer Note (ii) |
| Total for three (3) Plantation Units | | | \$15,120 | \$2,520 |

- (i) Section 82KZM applies as the pre-payment is for >13 months and the eligible service period commences on 1 July 2000.
- (ii) Details of the amount of interest incurred must be obtained from the credit provider.

Other Business (non-small business) Taxpayers***Growers who are not ‘small business taxpayers’ who choose not to pre-pay fees***

52. For a Grower who is **not a ‘small business taxpayer’** and is carrying on a business, who invests in the project on or before

28 June 2000 and chooses not to pre-pay fees, the deductions available are as set out in paragraph 47 above.

53. For a Grower who is **not a ‘small business taxpayer’** and is carrying on a business, who invests in the project after 28 June 2000 and chooses not to pre-pay fees, the deductions available are the same as set out in paragraph 48 above.

Growers who are not ‘small business taxpayers’ and who pre-pay fees

54. For a Grower who is **not a ‘small business taxpayer’** and is carrying on a business, who invests in the Project on or before 28 June 2000 and pre-pays the Planting, Management and Lease fees, the following occurs:

- The Planting Fee of \$600 is deductible in the year it is incurred and not affected by section 82KZMB, as it is less than \$1,000 (subsection 82KZMA(4)); and
- The Management and lease fees are affected by section 82KZMD as the eligible service period is greater than 13 months, and the allowable deductions are calculated according to the formula in subsection 82KZMD(2) and will be as per the table shown at paragraph 50.
- Deductions available in respect of the Primary fees that are not pre-paid are as set out in paragraph 47 above.

55. For a Grower who is **not a ‘small business taxpayer’** and is carrying on a business, who invests in the project after 28 June 2000 and pre-pays the Lease and Management fees, the deductions available are the same as set out in paragraph 51 above.

Sections 82KZMD, 82KL and Part IVA

56. For a Grower who is **not a ‘small business taxpayer’** and is carrying on a business, who invests in the Project the following provisions have application as indicated:

- pre-payment of the Management and Lease fees do fall within the scope of section 82KZMD, as outlined in paragraph 54 above;
- 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.

Proposed new laws

Proposed changes to prepayment rules

57. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999, will be subject to these changes.

58. For these Growers, the amount of deduction available in respect of the Management and Lease fees is calculated using the formula shown below (see also Example 2 at paragraph 101). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 ITAA 1997 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

$$\text{Deduction} = \text{Expenditure} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

The excess remaining after the application of this formula is deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers –

59. Product rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of 'tax shelter' arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Losses from non-commercial business activities

60. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business activity will not be allowed as deductions in the year that they arise.

These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an individual with a loss from a primary production business activity where their non primary production assessable income for the income year (excluding any net capital gain) is less than \$40,000 (proposed subsection 35-10(4)).

61. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-45 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

62. The Project's agreements, its (draft) prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b).

63. Provided the provisions are enacted as introduced, subject only to the above condition relating to the Arrangement (discussed below at paragraphs 110 and 111), exercise of the discretion will mean Growers can deduct losses arising from their interest(s) in the Project in the years that such losses arise.

Explanations

Sections 27-5 and 27-30

64. Section 27-30 of the ITAA 1997 operates to deny a deduction that would otherwise be available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and on or before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled on or after 1 July 2000.

65. Section 27-5 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (on or after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment a Grower has.

Subdivision 960-Q: small business taxpayers

66. In this product ruling the term ‘small business taxpayer’ is relevant for the purposes of certain pre-paid expenditure.

67. Whether or not a Grower is a ‘small business taxpayer’ depends upon the individual circumstances of each Grower and is beyond the scope of this product ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a ‘small business taxpayer’.

68. A ‘small business taxpayer’ is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their ‘average turnover’ for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

69. ‘Average turnover’ is determined under section 960-340 by reference to the average of the taxpayer’s ‘group turnover’. The group turnover is the sum of the ‘value of business supplies’ made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

Section 8-1: lease and management fees

70. Consideration of whether lease and management fees are deductible under section 8-1, begins with paragraph 8-1(1)(a) and is made 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 paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

71. An afforestation project 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 assessable income in their own right. The generation of ‘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.

72. Generally, a Grower will be carrying on a business of afforestation where:

- the Grower 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 Grower'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.

73. For this Project Growers have, under the Lease or Forest Right and Management Agreement, rights in the form of a Lease or a Forest Right over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Lease or Forest Right and Management Agreement Growers appoint ITCPM, as Responsible Entity, to provide services such as supplying seedlings, planting, fumigating and poisoning for exterminating and controlling the Plantation Unit from rabbits, insects and other vermin, spraying for control of weeds, fertilising, cultivating, tending and otherwise caring for the trees as and when required according to good silvicultural and forestry practices. Growers are considered to control their investment. The specific cost of the services provided by 30 June 2000 is \$3,000 plus \$3,000 per Plantation Unit. The cost of the services to be provided by 30 June 2001 are: for Management; a fixed fee of \$200 and a \$150 fee per Plantation Unit; a planting fee of \$200 per Plantation Unit; and a rental fee of \$250 (indexed) per Plantation Unit.

74. The Lease or Forest Right gives Growers the full right, title and interest in the products and the right to sell or have the products sold for their benefit (clause 3) until the end of the lease term.

75. Growers have the right to use the land in question for afforestation purposes and to have the Responsible Entity come onto the land to carry out its obligation under the Management Agreement. The Growers' degree of control over the Responsible Entity, 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 the state of the Tree Crop and ITCPM's activities. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as where the Responsible Entity has failed to perform any of its duties with due care and diligence. The afforestation activities described in the Lease or Forest

Right Agreements and Management Agreements are carried out on the Growers' behalf.

76. 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. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Draft Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, ie, a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction. The Independent Forester's assessment was that plantation yields will be economically viable.

77. 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.

78. 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.

79. 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, therefore, come within paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under section 8-1 are met. The exclusions of section 8-1 do not apply.

Section 82KZM: pre-paid expenditure for small business taxpayers

80. Section 82KZM operates to spread over more than one income year a deduction for pre-paid expenditure that would otherwise be immediately deductible, in full under section 8-1. The section applies to certain expenditure incurred under an agreement in return for doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

81. Under the Management Agreement a fixed fee of \$3,000 plus a fee of \$3,000 per Plantation Unit will be incurred on the execution of that Agreement. The fee is charged for providing Primary Services to

a Grower by 30 June of the year of execution of the Agreement. The fee is expressly stated to be for a number of specified services. 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.

82. There is also no evidence that might suggest the services covered by the fee could not be provided in the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Project Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to this expenditure incurred by Growers who are 'small business taxpayers'.

83. Under the Management Agreement a Grower making a pre-payment of planting, lease and management fees will, in addition to the Primary Services fees as set out in paragraph 77 incur the following expenses on the execution of that Agreement:

| | |
|--------------------------------------|---------|
| Planting – per Plantation Unit | \$200 |
| Management Fee – fixed amount | \$3,600 |
| Management Fee – per Plantation Unit | \$2,700 |
| Lease Fee – per Plantation Unit | \$4,500 |

84. The fee of \$200 for planting is for planting services to be provided from 1 July 2000 to 30 June 2001. 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 to suggest the services covered by the fee could not be provided within 13 months of the expenditure being incurred.

85. Thus, for the purposes of this Ruling, it is accepted that no part of the Planting Fee of \$200 is for the Manager to do 'things' that are not to be done wholly within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Growers, who are 'small business taxpayers'.

86. The fees payable for the lease and management of the Plantation Units are for the leasing and managing services to be provided over an 18 year period from 1 July 2000 to 30 June 2018. For this Ruling's purposes, no explicit conclusion can be drawn from

the arrangement's description that the fees have 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.

87. Thus, for the purposes of this Ruling, it can be accepted that a part of the Lease and Management fees are for the Manager doing 'things' that are not to be wholly done within 13 months of when the fees were incurred. On this basis, the basic preconditions for the operation of section 82KZM is satisfied. That section will operate to limit the deduction allowable for the pre-paid expenses incurred on lease and management services. Accordingly Lease and Management fees that are pre-paid will be deductible over a 10 year period. Growers, who are 'small business taxpayers' may deduct an amount equal to one tenth of the amounts incurred in any one year.

82KZMA to 82KZMD: pre-paid expenditure for non-small business taxpayers

88. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

89. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for pre-payments incurred in the transitional period, for things to be done wholly within 13 months. Section 82KZMD governs the deductibility of pre-paid expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred.

Primary services payment

90. Under the Management Agreement a fixed fee of \$3,000 plus a fee of \$3,000 per Plantation Unit will be incurred for Primary Services on execution of that agreement. The fee is charged for the provision of Primary Services to a Grower. Where the Grower invests on or prior to 28 June 2000 the services will be provided by 30 June 2000.

91. Where the Grower invests on or prior to 28 June 2000 there is no evidence to suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling it can be accepted that no part of the Primary Services fee is for the Manager

doing ‘things’ that are not to be wholly done within the year of income of the fee being incurred. The basic preconditions for the operation of sections 82KZMB and 82KZMC are not satisfied; therefore they will not apply to the expenditure on Primary Services by the Growers who are not small business taxpayers.

92. Where the Grower invests after 28 June 2000 there will be no execution of agreements or leases until after 30 June 2000. There is no evidence to suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling it can be accepted that no part of the Primary Services fee is for the Manager doing ‘things’ that are not to be wholly done within the year of income of the fee being incurred. The basic preconditions for the operation of sections 82KZMB and 82KZMC are not satisfied; therefore they will not apply to the expenditure by the Growers who are not small business taxpayers.

Planting pre-payment

93. The services provided in respect of the Planting Fee will be completed within 13 months after the day on which the expenditure is incurred. Thus for Growers who are small business taxpayers the amount is deductible when it is incurred.

94. For Growers who are not small business taxpayers the amount of the deduction available is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

95. An amount of expenditure that is less than \$1,000 is fully deductible in the year incurred (subsection 82KZMA (4)).

Lease and management pre-payment

96. The Lease and Management fees payable on application are:

| | |
|--------------------------------------|---------|
| Lease Fee – per Plantation Unit | \$4,500 |
| Management Fee – fixed amount | \$3,600 |
| Management Fee – per Plantation Unit | \$2,700 |

97. The services to be provided in respect of the Lease and Management fees will not be completed within 13 months after the day on which the expenditure in question is incurred. Thus, for the purposes of this Ruling, it is accepted that a part of the initial fee is for the Manager doing ‘things’ that are not to be wholly done within 13 months after the fee is incurred. On this basis, the basic preconditions

for the operation of section 82KZMD is satisfied. The provisions will apply to the Lease and Management fees for a Grower who is not a small business taxpayer and who pre-pays Lease and Management expenditure. Accordingly Lease and Management fees that are pre-paid will be deductible over a 10 year period. Growers, who are 'small business taxpayers' may deduct an amount equal to one tenth of the amounts incurred in any one year.

Proposed changes to prepayment rules

98. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

99. A tax shelter arrangement is described as existing where:

- under the arrangement, the taxpayer's allowable deductions for the income year exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g., a manager) other than the taxpayer; and
- either:
 - more than one taxpayer participates in the arrangement; or
 - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

100. The arrangement relating to the Project and described at paragraph 17 to 44 of this Product Ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee and the Lease Fee incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for this apportionment is expected to be the same as that currently shown in subsection 82KZMD(2).

Section 82KL

101. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, there may be a loan provided by ITC 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 deductions otherwise allowable under section 8-1.

Part IVA

102. 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 Project will be a ‘scheme’, commencing when the Prospectus is issued. The Growers will obtain an initial ‘tax benefit’ from entering into the scheme, in the form of the deduction for the initial fee, 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.

103. 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. The Independent Forester’s Report contained in the Prospectus states that the Project should achieve its financial objective if the forestry regimes set out in the report are followed, good marketing arrangements are put in place and the international economy and climatic factors (especially annual rainfall) are favourable. There are no features of the Project 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.

Assessable income

104. For a Grower who invests in the Project, any income received from the sale of timber produce or carbon credits from the Grower’s Area will be assessable income under section 6-5.

Proposed changes to losses from non-commercial business activities

105. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

106. In broad terms, the statutory tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

107. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in section 35-55(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

108. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2008 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

109. The discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for individual investors who acquire interests in the Project, the Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

110. The discretion in paragraph 35-55(1)(b) may be exercised where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

111. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above in the manner described in the Arrangement, the Commissioner's discretion will not have been exercised as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

112. In deciding to exercise his discretion, should the proposed new law be enacted as introduced into Parliament, the Commissioner has relied upon:

- the report of the independent forester and additional expert or scientific evidence provided with the application by the Responsible Entity;
- independent, objective and generally available information relating to the afforestation industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity;
- anything else that may be relevant to the specific project and when, judged against industry norms, it would be reasonably expected that the business activity will pass 1 of the 4 objective tests, or produce a taxation profit.

Examples

113. Example 1: Obligation to pre-pay expenditure arising on or after 11.45am AEST 21 September 1999 and before 1 pm AEST 11 November— applies to taxpayers who are not small business taxpayers and are carrying on a business:

Joseph Gardener has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to pre-paid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable in advance on 1 June each year for services to be provided for the following 12 months, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph is unable to deduct the whole of his pre-paid management fees in the years in

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which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that ‘shade-in’ the effect of the changes to the pre-payment laws.

For 1999/2000 Joseph can claim a deduction of \$4,899 for expenditure incurred before 30 June 2000 on management fees. This amount is calculated as A + B where:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$= \$6,000 \times \frac{30}{365} = \$493$$

$$B = (\text{Management fee less } A) \times 80\%$$

$$= (\$6,000 - \$493) \times 80\% = \$4,406$$

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e., \$1,101) is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of \$1,861 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 60\% = \$661$$

$$C = \$1,101$$

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the \$1,200 management fees pre-paid on 1 June 2001 (i.e., \$440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with Product Rulings, ‘capping provisions’ will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, for 2001/2002, Joseph can claim a deduction of \$980 for expenditure incurred on or after 1 July 2001 and on or before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 40\% = \$441$$

C = \$440

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the \$1,200 management fees pre-paid on 1 June 2002 (i.e., \$660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

114. Example 2: Obligation arising after 1 pm AEST 11 November 1999 to pre-pay expenditure – applies to all taxpayers investing in ‘tax shelter arrangements’:

Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a ‘tax shelter arrangement’. For the Management fee of \$6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

$$\begin{array}{l} \text{Management fee X } \frac{\text{Number of days of eligible service period in the}}{\text{expenditure year}} \\ \text{Total number of days of the eligible service period} \\ \$6,000 \text{ X } \frac{30}{365} = \$493 \end{array}$$

In the following year Joseph can claim the balance of the \$6,000 pre-payment (i.e., \$5,507) because that is the year in which the services are to be provided. The second and third year’s management fees are calculated using the same method.

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Subject references:

- carrying on a business
- commencement of business
- afforestation
- management fee expense
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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