


PR 2000/99 - Income tax: Gunns Plantations Woodlot Project 2001

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 This document has changed over time. This is a consolidated version of the ruling which was published on *13 September 2000*



Product Ruling

Income tax: Gunns Plantations Woodlot Project 2001

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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**, **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 laws' identified below apply to the defined class of persons, who take part in the arrangements to which this Ruling relates. In this Ruling these arrangements are sometimes referred to as the Gunns Plantations Woodlot Project 2001, 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 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZM and sections 82KZMB – 82KZMD (ITAA 1936);
 - sections 82KZME - 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of

those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. 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 any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. 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'.

8. 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 the Project.

Qualifications

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

10. If the arrangement described in this 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

12. This Ruling applies prospectively from 13 September 2000, 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).

13. 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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Gunns Plantations Woodlot Project 2001 Application for Product Ruling dated 23 June 2000;

- Draft **Prospectus** prepared to be issued by Gunns Plantations Limited ('Gunns Plantations' or 'the Responsible Entity') for the Gunns Plantations Woodlot Project 2001 dated 9 August 2000;
- Draft **Management Agreement** between Gunns Plantations (as the Manager) and the Grower dated 2 August 2000;
- Draft Lease Agreement between the Landlord and Gunns Plantations (as the Tenant), dated 23 June 2000;
- Draft **Sub-Lease Agreement** between Gunns Plantations (as the Sub-Landlord) and the Grower dated 23 June 2000;
- Draft Gunns Plantations Woodlot Project 2001 Constitution dated 4 August 2000;
- Draft **Loan Agreement** between Gunns Finance Pty Ltd ('GFPL') and the Borrower, undated;
- Draft **Woodsale Agreement** between Gunns Plantations (as agent for each Grower) and the Purchaser dated 22 June 2000;
- Facsimile from Applicant's advisors dated 15 August 2000; and
- Facsimile from Applicant's advisors dated 18 August 2000.

Note: certain information 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 Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate¹ of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

17. The arrangement is the Gunns Plantations Woodlot Project 2001.

¹ In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936.

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Location	A number of specified parcels of land in Northern Tasmania.
Type of business each participant is carrying on	Commercial growing of trees under one of three options: Option 1: Eucalyptus for Hardwood Pulpwood. Option 2: Eucalyptus for Hardwood Veneer and Pulpwood. Option 3: Radiata Pine for Softwood Veneer and Sawlogs.
Number of hectares under cultivation	There is a target of 5000 hectares under the prospectus, however, oversubscriptions may be accepted.
Name used to describe the product	Gunns Plantations Woodlot Project 2001.
Size of the leased area	One hectare
Number of trees per hectare	Minimum average of 1,100 for options 1 and 2, and 1,000 for option 3
The term of the investment	Option 1: 13 years Option 2: 20 years Option 3: 25 years
Initial cost per hectare	Application Fee of \$5,280 in the year ended 30 June 2001 and Planting Fee of \$440 in the year ended 30 June 2002
Ongoing costs	Gunns Plantations is to be paid \$44 (CPI Indexed) as an annual maintenance fee and \$286 (CPI Indexed) as an annual rental fee, payable annually in arrears.

18. Growers participating in the Project enter into a Sub-Lease Agreement with Gunns Plantations as the Sub-Landlord which gives them a lease over an identifiable area of land called a Woodlot from Gunns Plantations for approximately 15 to 25 years, depending on which option is chosen. The Growers will also contract with Gunns Plantations as the Responsible Entity, under a Management Agreement, to have eucalyptus or radiata pine planted on their leased land for the purpose of eventual felling and sale in approximately 15 or 20 years in the case of eucalyptus or 25 years in the case of radiata pine.

19. Under the Prospectus, the Responsible Entity undertakes to ensure that all Establishment Services are provided in relation to each Woodlot by 30 June 2001. From 1 June 2001, Gunns Plantations will not accept applications for any Woodlots where it is reasonably apparent that they will not be able to complete all of the Establishment Services in relation to those Woodlots by 30 June 2001. Gunns Plantations will be monitoring on a daily basis its ability to complete the establishment services by 30 June 2001. Approximately 1,100 trees per hectare for options 1 and 2, and 1,000 trees per hectare for option 3, will be planted between 1 July 2001 and 30 June 2002.

20. Under the prospectus, Gunns Plantations will offer Woodlots of one hectare for an initial cost of \$5,280. Gunns Plantations has the right to accept oversubscriptions. There is no minimum amount that must be raised under the Prospectus. The land for the Project has been leased by Gunns Plantations either from Gunns Limited or a third party land owner. Gunns Plantations is a wholly owned subsidiary of Gunns Limited.

21. Possible projected returns for the Project depends on a range of assumptions and Gunns Plantations does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Sub-Lease and Management Agreements in question. The financial projections set out in section 8 of the Prospectus show a 'before-tax' profit to the Growers over the term of the arrangement.

Sub-lease and Management Agreements

22. Under the Sub-Lease and Management Agreements, Growers enter into a 13 to 25 year lease for one or more Woodlots and contract with Gunns Plantations to establish and maintain the plantation until maturity. Clause 3 of the Sub-Lease Agreement grants an interest in the land to the Grower. Growers are not entitled to assign their rights under the Sub-Lease and Management Agreements, except in certain circumstances (cl 26.3 of the Management Agreement). Statements of interest are issued to Growers. Gunns Plantations keeps a register of Growers. Growers execute a power of attorney enabling Gunns Plantations to act on their behalf as required.

23. Growers may elect to harvest their own timber produce (cl 19 of the Management Agreement), or have Gunns Plantations, acting as their agent, sell the timber produce on the Grower's behalf (cl 11.1 of the Management Agreement), for the best possible commercial price (cl 5 of the Wood Sale Agreement). Gunns Limited has the first right of refusal to purchase the timber produce. In accordance with the Management Agreement and the Constitution, each Non-Electing Grower is entitled to a distribution of that Grower's proportional interest in the Wood Sales Proceeds for the option(s) they have chosen

less costs and any unpaid expenses applicable to that particular Grower.

Establishment and maintenance of the plantation

24. Gunns Plantations has the capacity and resources to carry out the establishment program prior to 30 June 2001. During the period commencing 1 July 2001, upon payment of the Planting Fee, Gunns Plantations will be responsible for planting eucalyptus or radiata pine on the Woodlots. From this period on, Gunns Plantations will maintain the trees in accordance with good silvicultural practice. The services to be provided by Gunns Plantations over the term of the Project are defined in clauses 4, 5 and 6 of the Management Agreement. Gunns Plantations will also be responsible for the maintenance of access roads and fire breaks, and is required to keep the Woodlots free from vermin.

25. Gunns Plantations will also be responsible for arranging the marketing and sale of the timber produce (clause 11.1 of the Management Agreement). The time for harvest will vary depending on the option selected and will be determined according to set criteria including growth rates, market demand, and volume of wood on the Woodlot (clauses 7 and 9 of the Management Agreement). Gunns Plantations will provide ongoing reports to the Growers on the progress of the plantation.

26. Gunns Plantations will ensure that the gross Wood Sale Proceeds and gross Carbon Rights Proceeds of each option are paid into the relevant portion of the Fund. The Non-Electing Growers' proportional shares of the costs of felling and costs of sale, will be paid to Gunns Plantations from the gross Wood Sale Proceeds. Gunns Plantations will receive from the Wood Proceeds Portion an amount equal to 3% of the gross Wood Sale Proceeds, as Sales Commission. This percentage has been calculated to ensure that Gunns Plantations makes a profit in providing these services. Growers' proportional share of costs of sale of Carbon Rights will be met out of the gross Carbon Rights Proceeds. 50% of the Net Carbon Rights Proceeds are paid to Gunns Plantations. The balance of the Wood Sale Proceeds and Net Carbon Rights Proceeds for each option will be held in the Fund on trust for the Growers.

Fees

27. The establishment fees payable under the Sub-Lease and Management Agreements are \$5,280 in the year ended 30 June 2001 and an additional Planting Fee of \$440 in the year ended 30 June 2002 for each Woodlot.

28. The independent forester considers that the Gunns Plantations Project has the potential to meet its financial objectives if the intensive forestry regimes proposed for the three options are followed and appropriate marketing arrangements are put in place.

29. The Application Monies will be banked into the Applications Portion reflecting the planting options chosen. These monies will be released to Gunns Plantations when certain specified criteria have been met (cls 8 and 9 of the Constitution).

30. Following provision of the establishment services by Gunns Plantations, Growers pay an annual maintenance cost of \$44 (CPI indexed) and annual rental of \$286 (CPI indexed) until final harvest. These fees are paid annually in arrears.

Finance

31. Growers can choose to fund their investment themselves, borrow from an unassociated lending body or borrow through a finance arrangement offered by Gunns Finance Pty Ltd (GFPL). The finance to be offered by Gunns Finance Pty Ltd will be on commercial terms. Interest will be calculated daily and payable monthly.

32. The provision of finance involves full recourse loans and GFPL will pursue legal action against defaulting borrowers.

33. This Ruling does not apply if a Grower enters into a finance agreement that includes 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 GFPL, provide finance to Growers 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 or rate of interest is non-arm's length;
- 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

Assessable income

34. A Grower's share of the gross sale proceeds from the Project less any GST payable on these proceeds, will be assessable income of the Growers under section 6-5 of the ITAA 1997. Section 17-5 ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Deductions where a Grower is not registered nor required to be registered for GST

35. A Grower may claim the deductions in the following Table where the Grower:

- participates in the project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 27 and 30; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 Year ended 30/6/2001	Year 2 Year ended 30/6/2002	Year 3 Year ended 30/6/2003
Application Fee	8-1	\$5,280 See note 1 below.		
Planting Fee	8-1		\$440 See note 1 below.	
Maintenance	8-1			\$44
Rent	8-1			\$286
Interest	8-1	See note 2 below.	See note 2 below.	See note 2 below.

Notes:

- Where a Grower incurs the fees as required by the Management Agreement, those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the

provision of management services or the planting of trees) that will not be wholly done in the same income year as the fees are incurred, then the prepayment rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 54 to 58 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than \$1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

- (ii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Gunns Finance Pty Ltd is outside the scope of this Ruling. However, Growers should read carefully the discussion of the prepayment rules in paragraphs 63 to 65 below, as those rules may be applicable if interest is prepaid.

Deductions where a Grower is registered or is required to be registered

36. Where a Grower who is registered or required to be registered for GST:

- participates in the project by 30 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 27 and 30; and
- is entitled to an input tax credit for the fees,

then the deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 84.

Section 35-55 – losses from non-commercial business activities

37. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling, for the applicable period as set out below:

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For growers participating in the following option:	The Commissioner will decide that the rule in section 35-10 does not apply to the business activity for the following period:
Option 1	income years ending 30 June 2001 to 30 June 2014
Option 2	income years ending 30 June 2001 to 30 June 2021
Option 3	income years ending 30 June 2001 to 30 June 2026

38. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 72 in the Explanations part of this Ruling, below).

Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

Sections 82KL, 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF and Part IVA

39. For a Grower who invests in the Project the following provisions of the ITAA 1936 have application as indicated:

- (i) section 82KL does not apply to deny the deductions otherwise allowable; and
- (ii) expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 51 to 58);
- (iii) expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 51 to 58);

- (iv) expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 51 to 58); and
- (v) 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.

Explanations

Section 6-5

40. For a Grower who invests in the Project, all income received or receivable by them from the sale of their timber and carbon rights, less any GST payable on these proceeds, will be assessable income to them under section 6-5 of the ITAA 1997.

Section 8-1

41. Consideration of whether application, planting, maintenance and rent 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 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. 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. 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.

Is the Grower carrying on a business?

42. 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 assessable income. 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.

43. 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.

44. Growers have, under the Sub-Lease and Management Agreements, 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 Management Agreement, Growers appoint Gunns Plantations, as Manager, to provide services such as planting, cultivating, tending, thinning, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. Growers are considered to have control of their investment. The specific cost to the Grower of these services provided during the period of provision of establishment services and rental is \$5,280 up to 30 June 2001 and an additional \$440 fee for planting up to 30 June 2002. Growers may either collect the Wood and arrange for its sale themselves or they have the option of Gunns Plantations arranging marketing and sale in return for a proportion of the sale proceeds.

45. The Sub-Lease Agreement gives Growers full right, title and interest in the *trees* and the right to have the *wood* sold for their benefit (cl 4.2 of the Sub-Lease Agreement). Growers will also own the carbon rights (if any) associated with the trees. The relevant documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees belong to the Growers in the

sense that they have an interest in the land on which they are growing and a profit à prendre in respect of the timber produce, which confers an equitable interest in the trees upon the Grower.

46. Growers have the right to use their Woodlots for afforestation purposes and to have Gunns Plantations come onto the land to carry out its obligations under the Sub-Lease and Management Agreements. The Grower's degree of control over Gunns Plantations, as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project documentation, Growers are entitled to receive regular progress reports on Gunns Plantations' activities. Growers are able to terminate arrangements with Gunns Plantations in certain instances, such as cases of default or neglect. The afforestation activities described in the Sub-Lease and Management Agreements are therefore carried out on the Grower's behalf.

47. 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 discussed in that Ruling. The independent forester's report is that the Project has the potential to meet its financial objectives if the intensive forestry regimes proposed are followed. 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.

48. 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.

49. 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.

50. 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 the business. They will thus be deductible under the first limb of section 8-1. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF

51. The prepayments provisions of the ITAA operate to spread over more than one income year, a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

52. In this Project, the Application Fee of \$5,280 per Woodlot will be incurred on execution of the Management Agreement. The fees are charged for providing to a Grower services by 30 June of the year of execution of the Agreements. In particular, the Application Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Application Fee has been inflated to result in reduced fees being payable for subsequent years.

53. There is also no evidence that might 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 initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 27, then the basic precondition for the operation of the prepayment provisions is not satisfied and the fees will be deductible in the year in which they are incurred.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

54. Although not required under either the Management Agreement or the Sub Lease Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 53 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

55. The amount and timing of tax deductions for any prepaid fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided. The relevant provision of the ITAA

will depend on a number of factors including the amount and timing of the prepayment and whether the Grower is a 'small business taxpayer'.

56. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the *expenditure was incurred*, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

57. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that *expenditure has been incurred*, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 66 to 68) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same or effectively the same as that shown in paragraph 56 above, concerning section 82KZMF.

58. A prepaid fee of less than \$1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

(i) Growers who use Gunns Finance Pty Ltd as the finance provider

59. Growers may finance their participation in the Project through a loan facility with Gunns Finance Pty Ltd.

60. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of cultivating and managing olive groves for the production of olive oil and is therefore, directly connected with the gaining of 'business income' from the Project. Such interest will,

therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1. As the loan facility offered by Gunns Finance Pty Ltd does not require a Grower to prepay interest, section 82KZME or 82KZMF will not apply. The interest will be deductible in full in the year in which it is incurred.

61. However, a Grower who, contrary to the requirements of the loan contracts offered by Gunns Finance Pty Ltd, chooses to prepay interest will be required to determine any tax deduction under the prepayment provisions of the ITAA.

62. Therefore, unless the prepaid interest is 'excluded expenditure', where a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 56 above.

(ii) Growers who DO NOT use Gunns Finance Pty Ltd as the finance provider

63. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Gunns Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

64. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid or a Grower may choose to prepay interest. Under the prepayment rules contained in section 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project, not described in the Arrangement or otherwise dealt with in the Product Ruling.

65. As in paragraph 62 above, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid or a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM

(for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 56 above.

Small business taxpayers

66. Whether 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 individual responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

67. 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.

68. 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).

Division 35 - losses from non-commercial business activities

69. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

70. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

71. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

72. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar

kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

73. In broad terms, the objective 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).

74. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests or produce a taxation profit within the period set out in the table at paragraph 37 for the Option selected by the Grower. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

75. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

76. The first arm of 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 an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

77. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner 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 will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

78. 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 (see paragraph 37), in the manner described in the Arrangement (see paragraphs 15 to 33), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

79. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent forester; and
- independent, objective, and generally available information relating to forestry industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by applicant.

Section 82KL - ITAA 1936

80. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by Gunns 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 - ITAA 1936

81. 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).

82. The Project will be a 'scheme' commencing generally on the date 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 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.

83. 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 fees being 'excessive', and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient 'real money' coming into the Responsible Entity's hands, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA. No ruling is given on the application of Part IVA to financing arrangements entered into between investors and other financiers in respect of lending arrangements to invest in the project.

Examples

Example 1 – entitlement to input tax credit

84. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any input tax credit to which she is entitled. The Project Manager provides Margaret with a tax invoice which includes its ABN and shows the price of the taxable supply for management services (\$5,500). Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Detailed contents list

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Commissioner of Taxation

13 September 2000

<i>Previous draft</i>	– ITAA 1936 82KZME(4)
Not previously issued in draft form	– ITAA 1936 82KZME(7)
	– ITAA 1936 82KZMF
<i>Related Rulings/Determinations:</i>	– ITAA 1936 82KZMF(1)
TR 92/1; TR 92/20; TD 93/34;	– ITAA 1936 Pt IVA
TR 97/11; TR 97/16; TR 98/22;	– ITAA 1936 177A
PR 1999/95	– ITAA 1936 177C
	– ITAA 1936 177D
<i>Subject references:</i>	– ITAA 1936 318
- carrying on a business	– ITAA 1997 6-5
- commencement of business	– ITAA 1997 8-1
- fee expenses	– ITAA 1997 17-5
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- schemes and shams	– ITAA 1997 35-10(3)
- taxation administration	– ITAA 1997 35-10(4)
- tax avoidance	– ITAA 1997 35-30
	– ITAA 1997 35-35
<i>Legislative references:</i>	– ITAA 1997 35-40
– ITAA 1936 82KL	– ITAA 1997 35-45
– ITAA 1936 82KZL	– ITAA 1997 35-55
– ITAA 1936 82KZL(1)	– ITAA 1997 35-55(1)
– ITAA 1936 82KZM	– ITAA 1997 35-55(1)(a)
– ITAA 1936 82KZM(1)	– ITAA 1997 35-55(1)(b)
– ITAA 1936 82KZMA	– ITAA 1997 960-335
– ITAA 1936 82KZMA(4)	– ITAA 1997 960-340
– ITAA 1936 82KZMB	– ITAA 1997 960-345
– ITAA 1936 82KZMC	– ITAA 1997 960-350
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