


PR 2007/43 - Income tax: NTT Mahogany Project 2006 - 2008 (2007 Growers) (Terms Option)

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Product Ruling

Income tax: NTT Mahogany Project 2006 – 2008 (2007 Growers) (Terms Option)

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! This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

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

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

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. 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 participants must form their own view about the commercial and financial viability of the product. We recommend a financial (or other) adviser be consulted for such information.

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

Terms of use of this Product Ruling

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

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the 'NTT Mahogany Project 2006 – 2008' (previously known as the 'NTT Mahogany Project No. 2') or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits.

3. The class of entities who can rely on those tax benefits are referred to as Growers. Growers will be those entities that are accepted to participate in the scheme as described in this Ruling on or after the date this Product Ruling is made and who have entered into relevant Project Agreements set out in paragraph 29 of this Ruling on or before 30 June 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities who:

- Intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 30 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement (PDS);
- have their Terms Agreement varied or replaced in any manner that falls outside the payment terms as described in this Ruling at paragraphs 59 to 64 of this Ruling;
- enter into any finance arrangements or any other arrangements other than the Terms Agreement as described; or
- elect to market and sell their own timber.

Superannuation Industry (Supervision) Act 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

6. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 29 to 64 of this Ruling.

7. Any conditions attached to this Ruling will take precedence over contracts/agreements to the Project where such conditions materially influence/change those contracts/agreements.

8. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Product Ruling may be withdrawn or modified.

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Date of effect

10. This Product Ruling applies prospectively from 16 May 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 16 May 2007 until 30 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities up to 30 June 2007.

11. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

12. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the Taxation Administration Act 1953 (TAA)).

13. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

14. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the law

15. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to the extent of those amendments this Product Ruling will be superseded.

16. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

17. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Goods and Services Tax

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

Ruling**Application of this Ruling**

19. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 29 to 64 of this Ruling.

20. The Grower's participation in the Project must constitute the carrying on of a business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of entry into the Project Operations Agreement and Woodlot Licence (or Growers Agreement to License), on or before 30 June 2007.

The Simplified Tax System (STS)***Division 328***

21. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS taxpayer' and must have elected to an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

22. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneur's tax offset***Subdivision 61-J***

23. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides for a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable income***Section 6-5***

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

25. The Grower recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

Deduction for Application Fee***Section 8-1***

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

Fee Type	ITAA section	Year ending 30 June 2007
Application Fee	8-1	\$6,900 See Notes (i) and (ii)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Under section 82KZMG of the ITAA 1936 the Application Fee for the Planting Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 86 to 88 of this Ruling) and is deductible in the income year in which it is incurred.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – exercise of Commissioner’s discretion***

27. A Grower who is an individual accepted into the Project by 30 June 2007 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described in this Ruling, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ended **30 June 2007 to 30 June 2023**. This conditional exercise of the discretion will allow those losses to be offset against the Grower’s other assessable income in the income year in which the losses arise.

Prepayment provisions and anti-avoidance provisions***Sections 82KZME, 82KZMF and 82KL and Part IVA***

28. For a Grower who participates in the Project and incurs expenditure as required by the Licence Agreement and the Project Operations Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

29. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling dated 14 September 2006 received 15 September 2006, including additional correspondence and e mails received 5 February 2007, 16 February 2007, 22 February 2007, 27 February 2007 and 13 April 2007;
- **Consolidated Constitution** for the NTT Mahogany Project 2006 – 2008 between Grower and Primary Securities Ltd dated 6 October 2006 and received on 30 April 2007;
- Rules for the NTT Mahogany Project No. 2 by Primary Securities Ltd dated 30 June 2006 and received on 30 April 2007;

- Planting Agreement for the NTT Mahogany Project No. 2 between Primary Securities Ltd and Northern Tropical Timbers Pty Ltd ('Planting Co') dated 28 February 2006 and received on 30 April 2007;
- Compliance Plan for the NTT Mahogany Project No. 2 dated 20 January 2006 and received on 30 April 2007;
- Maintenance Agreement for the NTT Mahogany Project No. 2 between Primary Securities Ltd and NTT Forestry Pty Ltd ('Land Co') dated 28 February 2006 and received on 30 April 2007;
- Processing and Marketing Agreement for the NTT Mahogany Project No. 2 between Primary Securities Ltd and NTT Timber Products Pty Ltd ('Timber Co') dated 28 February 2006 and received on 30 April 2007;
- Option to Purchase Property – M'Oganwo Station between NTT Land Holdings Pty Ltd (as the Land Owner) and NTT Forestry Pty Ltd dated 9 June 2006 and received on 30 April 2007;
- Head Lease between NTT Land Holdings Pty Ltd and NTT Forestry Pty Ltd and registered with the Land Title's Office in the Northern Territory on 4 September 2006 and received on 30 April 2007;
- Sub-Lease between NTT Forestry Pty Ltd and Primary Securities Ltd and registered with the Land Title's Office in the Northern Territory on 4 September 2006 and received on 30 April 2007;
- **Grower's Agreement to License** for the NTT Mahogany Project No. 2 between Primary Securities Ltd and the Grower, and received on 30 April 2007;
- Performance Guarantee & Indemnity for the NTT Mahogany Project No. 2 by NTT Land Holdings Pty Ltd, NTT Forestry Pty Ltd, Northern Tropical Timbers Pty Ltd and NTT Timber Products Pty Ltd in favour of Primary Securities Ltd dated 28 February 2006 and received on 30 April 2007;
- Responsible Entity Services Agreement for the NTT Mahogany Project No. 2 between Primary Securities Ltd and Northern Tropical Timbers Pty Ltd, NTT Forestry Pty Ltd and NTT Timber Products Pty Ltd, dated 28 February 2006 and received on 30 April 2007;
- Supplementary Product Disclosure Statement for NTT Mahogany Project 2006 – 2008 dated 26 February 2007 and received on 30 April 2007;

- **Consolidated Project Operations Agreement** NTT Mahogany Project 2006 – 2008 between Grower and Primary Securities Ltd and received on 30 April 2007;
- **Consolidated Woodlot Licence** NTT Mahogany Project 2006 – 2008 (Northern Territory Land) between Grower and Primary Securities and received on 30 April 2007;
- Product Disclosure Statement for NTT Mahogany Project 2006 – 2008 dated 1 November 2006 and received on 14 December 2006;
- **Terms Agreement** for the NTT Mahogany Project 2006 – 2008 and received on 30 April 2007;
- Deed of Subordination for the NTT Mahogany Project No. 2 between Primary Securities, Northern Tropical Timbers Pty Ltd and Karehana Pty Ltd dated 20 June 2006 received on 30 April 2007; and
- Custodian Agreement for NTT Mahogany Project No. 2 between Primary Securities and Robert Garton Smith trading as Garton Smith & Co dated 30 January 2006 and received on 30 April 2007.

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

30. The documents highlighted are those that Growers will enter into in addition to the Application form in the Product Disclosure Statement. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme to which this Ruling applies.

31. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

32. This scheme is called the NTT Mahogany Project 2006 – 2008. A description of the scheme follows:

Location	M'Oganwo Station in the Douglas Daly region in the Northern Savanna area of the Northern Territory, 160km south of Darwin or further land in the Douglas Daly region of the Northern Territory.
Type of business to be carried on by each participant	Commercial growing and cultivation of <i>Khaya senegalensis</i> (African Mahogany) for the purpose of harvesting, milling and selling timber.
Number of hectares offered for cultivation	1,000 or more if oversubscriptions are accepted.
Size of each Woodlot	0.25 hectares
Number of trees per hectare	568
Term of the Project	16 years
Initial Cost per Woodlot	\$6,900
Ongoing and other costs	<ul style="list-style-type: none"> • Licence fee of 5% of Net Proceeds of Sale • Maintenance Fee of 5% of Net Proceeds of Sale • Marketing Fee of 5% of Net Proceeds of Sale • Costs of harvest and sale payable out of Gross Proceeds of Sale • Potential Incentive Fee • Potential Fee of Last Resort
Minimum subscription	<ul style="list-style-type: none"> • 100 Woodlots
Minimum allocation and costs	<ul style="list-style-type: none"> • 2 Woodlots • at a minimum allocation cost of \$13,800

33. The Project is registered as a Managed Investment Scheme under the Corporations Act 2001. Primary Securities has been issued with Financial Services Licence Number 244107 and will be the Responsible Entity for the project. The Project will be conducted on land located in the Douglas Daly region of the Northern Territory on a property known as 'M'Oganwo Station' and on further land that will be acquired in the Douglas Daly region of the Northern Territory. 'M'Oganwo Station' is more particularly described as the land on NT Portion 6069 from plan(s) S2000/223A and being the whole of the land comprised in Certificate of Title Volume 689 Folio 208.

34. This Project pertains to 4,000 Woodlots of 0.25 hectares each offered under a Product Disclosure Statement ('PDS'). The minimum allocation per participant is two Woodlots totalling 0.5 hectares in size. There is a minimum subscription of 100 Woodlots for this Project.

35. Growers participating in the scheme will enter into a Licence Agreement. Under this Licence, Growers license an area of land called a 'Woodlot' for a term of approximately 16 years for the purpose of Tree Farming. Each Woodlot will be planted with Mahogany seedlings at the rate of no less than 568 trees per hectare. In the event that there are oversubscriptions and no suitable land available, Growers will first enter into the Grower's Agreement to License pending suitable land being selected upon which they will then enter into the Licence.

36. Under this offer, Growers may enter the Project in the 2007 income year. Growers who are allotted Woodlots during the income year ended 30 June 2007 are defined as '2007 Growers' for the purpose of this Ruling and may be covered by this Ruling where they enter into a Terms Agreement. However 2007 Growers who do not enter into a Terms Agreement are outside the scope of this Ruling and may be covered by PR 2006/35 or PR 2006/101.

37. The Growers will also enter into a Project Operations Agreement with the Responsible Entity for the management of their Woodlots. The Responsible Entity sub-contracts the Planting Co and the Land Co to provide these services. The Planting Co will be responsible for planting the Trees and the Land Co for cultivating the Trees. Growers may elect to harvest and sell their own timber by notice in writing to the Responsible Entity by 30 June 2009. Alternatively, the Responsible Entity will sub-contract the harvest and selling of the Timber on behalf of the Growers to the Timber Co under the Processing and Marketing Agreement. A non-commercial thinning of 284 Trees per hectare will be undertaken prior to year 6. Harvests are expected to take place when the Trees are aged 10 and 15 years.

38. The Responsible Entity will accept applications made by Growers where the Application Fees are paid in accordance with the 'Terms Agreement'.

39. The Licence (or Grower's Agreement to License) and Project Operations Agreement come into effect on acceptance of a Grower's Application by the Responsible Entity.

Constitution

40. The Constitution establishes the Project and operates as a deed binding on all Growers and Primary Securities Ltd. The Constitution sets out the terms and conditions under which Primary Securities Ltd agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project. In order to acquire an interest in the Project, the Grower must make an application for Woodlots and the Responsible Entity must accept the Application in accordance with clause 3. The Responsible Entity will deposit all Application Fees received from Applicants in a Project Account (paragraph 6(a)).

41. Once the Responsible Entity has accepted the Application all of the Project Documents are deemed to have been entered into by the Grower (clause 6). The Grower shall pay the Management Fee and Project Fees to the Responsible Entity by the date for payment under the Woodlot Licence or the Project Operations Agreement, as the case may be.

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

- various Agreements between parties to the project;
- the application process;
- the Responsible Entity's powers; and
- commencement and termination of the Project.

Compliance Plan

43. As required by the *Corporations Act 2001*, a Compliance Plan has been prepared for the Project. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Licence (or Grower's Agreement to License)

44. Primary Securities Ltd procures the land from the Land Co via a Sub-Lease. Growers participating in the scheme will then enter into a Licence Agreement with Primary Securities Ltd in its capacity as Responsible Entity. Growers are granted a Licence to use their Woodlots for the purpose of conducting their afforestation business upon the terms and conditions as set out in the Woodlot Licence. The Woodlot Licence will commence on the date Woodlots are allotted to Growers and will continue for 12 years, the maximum allowed under Northern Territory law. After this date, the Woodlot Licence will be renewed until the completion of the final harvest approximately four years later. In the event that there are over subscriptions and no suitable land available, Growers will enter into the Grower's Agreement

to License pending suitable land being selected upon which they will enter into the Licence. This Product Ruling will not apply to any Grower who does not enter into a Licence within 9 months of the first 2007 Grower entering into a Grower's Agreement to License.

45. Each Grower must pay a Licence Fee to the Responsible Entity from Net Proceeds of Sale.

Project Operations Agreement

46. The Project Operations Agreement is between the Grower and Primary Securities Ltd as the Responsible Entity. Each Grower agrees to engage the Responsible Entity of the Project to perform services under the Agreement.

47. The Project Operations Agreement sets out all the services to be performed under this agreement. The Planting Services are those services to be performed under the Planting Agreement relevant to the main planting and establishment of the Trees on the Woodlots. These include:

- tending to the seedlings prior to planting;
- ripping;
- mounding;
- applying fertiliser or herbicide to the seedlings prior to and during planting; and
- planting the seedlings.

48. The Planting Services will be completed within 12 months of the Growers Application being accepted. This is set out in the Project Operations Agreement. The Responsible Entity will sub-contract the performance of these services to Planting Co under the terms of the Planting Agreement.

49. The Responsible Entity is contracted under the Project Operations Agreement to perform the Maintenance Services. The Responsible Entity will sub-contract the performance of these services to Land Co under the terms of the Maintenance Agreement. These services include:

- tending to the Trees according to the principles of good forestry, including such nutrient analysis, pruning, fertilising and fumigating as Land Co deems appropriate to promote Tree growth and yields; and
- managing the Trees in accordance with the Planting Plan and the Maintenance Plan.

Maintenance Agreement

50. The Maintenance Agreement is between Primary Securities Ltd as the Responsible Entity and Land Co. This Agreement appoints Land Co to perform the maintenance obligations of the Responsible Entity under the Project Operations Agreement.

Planting Agreement

51. Under the Project Operations Agreement the Grower agrees to engage the Responsible Entity to select and purchase plant-stock to enable the cultivation of trees. These services are sub-contracted to the Planting Co under the Planting Agreement which during the first 12 months of the Project will plant sufficient Trees to an average of 142 trees per Woodlot. The Land Co will conduct a survival count within 13 months of planting the Trees and replant as necessary.

Processing and Marketing Agreement

52. The Grower has an interest in the Trees to be planted on the Woodlot and a right to the Timber from those Trees. Harvesting will take place as and when deemed appropriate by the Responsible Entity and the Timber Co. in producing the best overall result for the Grower. The Responsible Entity expects to conduct non-commercial thinning of 50% of the Trees in year 6 and a harvest of 25% in year 11. The remaining Trees will be harvested in the final year of the Project.

53. The proceeds from the sale of the Grower's Timber will be paid directly to the Responsible Entity which must then be deposited into the Trust Account. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to pay the Adjusted Prescribed Proportion of the Timber Production Costs (unless the Grower has made an election to sell their Timber under the Project Operations Agreement); and then
- to pay to the Responsible Entity any outstanding Management Fees or Project Fees owing by the Grower to the Responsible Entity under the Constitution or any of the Agreements; and then
- to distribute the Adjusted Prescribed Proportion of the balance to the Grower (unless the Grower has made an election to sell their Wood under the Project Operations Agreement) unless the aggregate sum to be distributed to all of the Growers is less than \$1,000.

Fees

54. The fee payable under the Project Operations Agreement per Woodlot, on allotment is the Application Fee of \$6,900.
55. Growers are also required to pay the following fees out of Net Proceeds of Sale on a per Woodlot basis:
- Licence Fee of 5% of Net Proceeds of Sale;
 - Maintenance Fee of 5% of Net Proceeds of Sale; and
 - Marketing Fee of 5% of Net Proceeds of Sale.
56. A Last Resort Management Fee may be imposed. If a Last Resort Management Fee has been imposed, the amount of that fee that has been paid will be deducted from the cumulative total of the Licence Fee, Maintenance Fee, Marketing Fee and Incentive Fee in calculating the Responsible Entity's entitlement to those fees.
57. The Grower is also required to pay an Incentive Fee of 25% to the Responsible Entity if the Net Harvest Return per Woodlot exceeds \$45,000.

Finance

58. A Grower who does not pay the Application Fee in full on Application can enter into a Terms Agreement with the Responsible Entity. **This Ruling only applies to those Growers who participate in the scheme and enter into a Terms Agreement with the Responsible Entity.**

Terms Agreement

59. All Growers to whom this Ruling applies will enter into a Terms Agreement with the Responsible Entity. All Terms Growers will be bound by the Terms Agreement. The conditions of the Terms Agreement are contained in the 'Terms Agreement NTT Mahogany Project 2006-2008', to which each Terms Grower is a party.
60. Primary Securities will be bound by the Terms Agreement including the variations in paragraph 63 and 64 of this Ruling.
61. Under the Terms Agreement a Grower will pay the Application Fee in 12 monthly instalments of \$575.
62. As security for payment of the amounts due under the Terms Agreement, the Terms Grower charges in favour of the Responsible Entity all the Terms Grower's right, title and interest in the Project.

63. The power of attorney in clause 6(kk) of the Constitution will not be exercised in any way which results in an extension of the terms payment or otherwise adjusts the terms of payment in any manner. The term 'varying' in clause 6(kk) of the Constitution will be interpreted so that it does not effect any deferral, extension or write off of any payments. If the Terms Agreement is replaced as provided in clause 6(kk) for whatever reason, the replacement agreement will not effect any deferral, extension or write off of any payments.

64. In exercising its right under clause 9.2 of the Terms Agreement to terminate the Terms Agreement, Primary Securities Ltd will observe ASIC's Debt Collection Guidelines, and subject to the Debt Collection Guidelines, will terminate a Terms Agreement if the Grower is in default for more than 60 days.

Commissioner of Taxation

16 May 2007

Appendix 1 – Explanation

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

Is the Grower carrying on a business?

65. For the amounts set out in the Table at paragraph 26 of this Ruling to constitute allowable deductions, the Grower's activities as a participant in the NTT Mahogany Project 2006 – 2008 must amount to the carrying on of a business of primary production.

66. Where there is a business, or a future business, the gross proceeds from the sale of timber from the Project 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.

67. For schemes such as that of the NTT Mahogany Project 2006 – 2008, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

68. Generally, an investor will be carrying on a business of afforestation, and hence primary production, if:

- the Grower has an identifiable interest (by lease or licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the timber from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with an afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

69. In this Project each Grower enters into a Licence and a Project Operations Agreement.

70. Under the Licence Agreement each individual Grower will have rights in the form of a licence over a specific and identifiable area of land. The Licence provides the Grower with an ongoing interest in the specific Trees on the licensed area for the term of the Project. Under the Licence, the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Licence, Sub-Lease and the Project Operations Agreement allows the Responsible Entity to come onto the land to carry out its obligations under any of the agreements.

71. Under the Project Operations Agreement the Responsible Entity is engaged by the Grower to establish and maintain the Trees on the Grower's licensed identifiable area during the term of the Project. The Responsible Entity will sub-contract the Planting Services to the Planting Co under the Planting Agreement, the Maintenance Services to the Land Co, under the Maintenance Agreement and the Harvesting Services to the Timber Co. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Trees on the licensed area on the Grower's behalf.

72. The Responsible Entity may also be engaged to harvest and sell, on the Grower's behalf, the timber grown on the Grower's licensed area.

73. 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 Project's description for all the indicators.

74. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of timber that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

75. The pooling of timber grown on the Grower's licensed area with the timber of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled timber will reflect the proportion of the Trees contributed from their licensed area.

76. The Responsible Entity's services are also consistent with general afforestation practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the size of a Woodlot is relatively small, the plantation is of a size and scale to allow it to be commercially viable (see Taxation Ruling TR 2000/8).

77. The Grower's degree of control over the Responsible Entity as evidenced by the Project Operations Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's licensed area and the activities carried out on the Grower's behalf. Growers are able to terminate schemes with the Responsible Entity in certain instances, such as cases of default or neglect.

78. 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. For the purposes of this Ruling, the Grower's afforestation activities in the NTT Mahogany Project 2006 – 2008 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

79. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

80. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Application Fee

Section 8-1

81. Consideration of whether the Application Fee is 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 before the business has commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

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

Prepayment provisions

Sections 82KZL to 82KZMG

83. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

84. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and section 82KZMG of the ITAA 1936 (an operative provision). References to sections 82KZME and 82KZMF of the ITAA 1936 are made only in respect of their interaction with section 82KZMG and to confirm that these provisions have no application to expenditure incurred by Growers who participate in the scheme set out in the Ruling.

Application of the prepayment provisions to this Project

Sections 82KZME and 82KZMF

85. Other than the Application Fee (see below) the fees payable under the scheme to which this Product Ruling applies are payable out of Net Proceeds of Sale. Accordingly the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to expenditure incurred by Growers under this scheme.

Section 82KZMG

86. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules in sections 82KZME and 82KZMF of the ITAA 1936 that would otherwise apply. Section 82KZMG provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure incurred under a plantation forestry management agreement. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees. Seasonally dependant agronomic activities are explained in Taxation Determination TD 2003/12. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of commencement of its eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936), and by the end of the following income year.

87. Under the Project Operations Agreement each Grower incurs an Application Fee of \$6,900 per Woodlot for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the Trees.

88. The expenditure for 'seasonally dependent agronomic activities' meets all other requirements of section 82KZMG of the ITAA 1936 and, therefore a deduction is allowable in the income year ended 30 June 2007 for the full amount of expenditure incurred by the Grower for the Application Fee.

Division 35 – deferral of losses from non-commercial business activities

89. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for **30 June 2007 up to and including 30 June 2023**, based on the evidence supplied, the Commissioner has determined that for those income years:

- because of its nature the business activity will not satisfy one of the four tests set out in Division 35;
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

90. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

91. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

92. For Part IVA of the ITAA 1936 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).

93. The NTT Mahogany Project 2006 – 2008 will be a 'scheme' commencing with the issue of the Product Disclosure Statement. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 26 of this Ruling 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.

94. 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. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

PR 2006/35; PR 2006/101;
TD 2003/12; TR 97/11;
TR 2000/8

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial business activities
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB

- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
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- ITAA 1936 82KZMG
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
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- Commission of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

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NO: 2006/17818
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ timber