Technical Bulletin

Why investors will not pay GST in ITC Projects in 2009

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Following the Federal Court decision in Hance v FC of T and Hannebery v FC of T, the ATO accepts that investors in most managed investment schemes are 'carrying on a business'. As a result, investors in these Projects are required to pay GST as part of the establishment costs.

However, investors in ITC 2009 Projects will not be required to pay GST, despite still benefiting from the 'up front' tax deducations which are available for investments in MIS projects with a favourable tax ruling.

Goods and Services Tax

The ATO does not consider investors in the type of structure used by the ITC Diversified Forestry Project, to be carrying on a "business" for income tax purposes.

Rather, the application fee relates to the grant of a forestry interest to the investor which is defined as a 'financial supply' for GST purposes.

As an example, paragraph 21 of PR2009/10 covering the ITC Limited Diversified Forestry Project 2009 specically states that "An investor... in the Project is not considered to be carrying on a business of primary production...". A similar statement appears in the product rulings which apply to the other two projects released by ITC Limited in 2009.

Is this an advantage or disadvantage to the investor?

- The investor will not be carrying on a business (i.e. enterprise) for GST purposes and will not be required to be registered for GST on this basis
- In terms of cashflow the investor will not be out of pocket for GST between the period of investment and the time that GST would have been refunded had GST been payable.

Managed investment scheme structures

Managed Investment Scheme (MIS) forestry projects can now be developed and offered to the market under a number of different structures.

ITC Limited is an example of a manager who has not used a 'tradiotional' MIS project structure for their 2009 projects as the following table illustrates

ITC 2009 Projects	'Traditional' Forestry Projects
Investor acquires a proportionate interest in the whole of the Project, and is not deemed to be carrying on a business in their own right.	Investor acquires a personal interest in a specific part of the Project (represented by the individual land interest) and agrees to pool produce for marketing purposes.
No GST is payable	GST is payable
Initial investment is 100% tax deducatible	Initial investment is 100% tax deductible
Manager carries on the forestry business of the Project.	Investor carries on business in respect of individual land interest and personally contracts for Manager to provide forestry and related services to the investor.
Investor receives a proportional share of the forestry income from the entire Project.	Investor's income is determined by reference to the number of woodlots (or equivalent units) held by each investor.
All deductions can be offset against any assessable income of the Investor, without meeting the usual non commercial loss requirements.	Investor deductibility is subject to non-commercial loss discretions granted in relevant Product Ruling.

* ITCPM - ITC Limited Project Management

Background

Under 8-1(1) of Income Tax Assessment Act 1997 (ITAA97), there are three limbs under which a deduction can be claimed in respect of an expense. An expense can be claimed if it is:

a. Incurred in gaining or producing assessable income
b. Necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income, or
c. Able to be claimed as a result of another section of the tax act.

Prior to 1 July 2008, it was commonly held that an investor (i.e. grower) in a MIS project was carrying on a business'. As such expenses, including establishment costs which would otherwise be considered to be capital in nature, could be claimed as a deduction in the year in which the expense was incurred.

In 2007 this view was opposed by the ATO, with the effect that as at 1 July 2008 the ATO held that an investor in a managed investment scheme could no longer claim a tax deduction for the establishment costs of a project under section 8-1(1)(b) of Income Tax Assessment Act 1997 (ITAA97).

The ATO's view was subsequently challenged and overturned in December 2008 in Hance v FC of T; Hannebery v FC of T [2008] FCAFC 196; 2008 ATC 20-085

However prior to this challenge the Government , which has a policy of encouraging private investment in forestry plantations (i.e. 2020 Vision), amended ITAA97 by inserting section 394-10. This new section enables investors in forestry MIS's to continue to claim establishment costs as a tax deduction, provided that the forestry MIS in which the investment is being made meets the conditions contained within Section 394-10.

Deductions can be claimed for Projects which meet the conditions of section 394-10, regardless of whether or not the investor is deemed to be carrying on a business.

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