


***TD 2009/D16 - Income tax: will a deduction remain allowable under section 8-1 of the Income Tax Assessment Act 1997 where a CGT event happens in relation to a taxpayer's interest in a section 82KZMG of the Income Tax Assessment Act 1936 forestry managed investment scheme within 4 years after the end of the income year in which the taxpayer first incurred expenditure under the agreement?***

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## Draft Taxation Determination

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Income tax: will a deduction remain allowable under section 8-1 of the *Income Tax Assessment Act 1997* where a CGT event happens in relation to a taxpayer's interest in a section 82KZMG of the *Income Tax Assessment Act 1936* forestry managed investment scheme within 4 years after the end of the income year in which the taxpayer first incurred expenditure under the agreement?

**❶ This publication provides you with the following level of protection:**

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### Ruling

1. No. Section 82KZMGA of the *Income Tax Assessment Act 1936* (ITAA 1936) applies to disallow the previously allowable expenditure.

### Example

2. Wane pays an amount under an agreement as part of a managed investment scheme in June 2006 and claims a deduction in that income year pursuant to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) and section 82KZMG of the ITAA 1936. The manager of the scheme is placed in liquidation in June 2009. Wane's interest ceases to exist under the terms of a liquidation in December 2009 and he receives nothing in return, as there is no value in the interest at that time. Section 82KZMGA of the ITAA 1936 applies in the 2009 income year to deny the deduction initially claimable in the 2005-06 income year.

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## **Class of persons**

3. This draft Determination applies to participants in schemes that are either subject to a current product ruling, or were subject to a product ruling which has been withdrawn with effect from immediately before any material difference occurred.

## **Date of effect**

4. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

## **Note**

5. The Assistant Treasurer made an announcement on 21 October 2009 in media release No. 074 that:

... the Rudd Government will amend the tax law to protect around 19,000 investors in forestry managed investment schemes (MIS) from an unintended tax outcome.

...

The Rudd Government will amend [the] four-year holding period rule for forestry MIS to ensure that it cannot be failed for reasons genuinely outside an investor's control...

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**Commissioner of Taxation**

28 October 2009

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## Appendix 1 – Explanation

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

### Explanation

6. A deduction for an amount paid by an investor in a forestry managed investment scheme on or after 1 July 2007 and on or before 30 June 2008 may be allowable under Division 394 of the ITAA 1997 or, alternatively, under section 8-1 of the Act if its terms are satisfied. Refer to the Explanatory Memorandum to the *Tax Laws Amendment (2007 Measures No. 3) Act 1997* (the Explanatory Memorandum) at paragraph 8.15.
7. If the expenditure is incurred on or before 30 June 2008 and is deductible under section 8-1 of the ITAA 1997, its timing may be governed by section 82KZMG of the ITAA 1936.
8. When Division 394 of the ITAA 1997 was introduced, two important matters were in contemplation. First, it was not clear that a deduction for a contribution to a forestry scheme was allowable at all under section 8-1 of the ITAA 1997 and litigation on the point was in contemplation. A corollary of this was the character of, and therefore the taxation treatment of, the sale proceeds from the harvested timber. The question at issue, in the main, turned on whether investors could be said to be carrying on a business. Accordingly, whilst a specific Division was enacted which sought to deal with these issues in a comprehensive way, if a forestry scheme did not qualify under the new Division 394, but otherwise satisfied section 8-1 as determined by the Courts, it was thought appropriate to enable that section to continue to apply.
9. Secondly, provisions were introduced that were intended to facilitate secondary trading of interests in such schemes. See generally the discussion in the Explanatory Memorandum from paragraphs 8.1 to 8.17.
10. A feature of the new Division, for initial investors, was to ensure that because a deduction was available for the amount paid into the scheme, the market value of the proceeds from a disposal of their interest in the scheme should be assessable income. For secondary investors, because they may 'inherit' on-going obligations, for example, in relation to management and service fees, as these costs are deductible, the first part of any sale or harvest proceeds will be treated as assessable income to the extent they represent the value of (or match) these deductions. The balance will be afforded capital gains tax treatment.
11. However, for an initial investor it was thought appropriate that revenue account symmetry should be modified if their interest was disposed of, or partly disposed of, before the end of the fourth year after the year in which the interest in the scheme was acquired.
12. A modified CGT treatment would be applied in these cases. The initial deduction would be disallowed, the market value of the proceeds was to be included in the assessable income (the pricing rule) but a capital loss would be available if the disposal proceeds were less than the cost of the initial interest.

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13. The position under the new Division 394 of the ITAA 1997 about secondary trading and the 4 year holding rule was intended to be replicated for existing forestry scheme interests where the initial deductions would have been allowable under section 8-1 of the ITAA 1997. See the Explanatory Memorandum at paragraphs 9.58 and 9.59.

14. Section 82KZMGA and section 82KZMGB of the ITAA 1936 achieve this outcome. They apply when any CGT event occurs in respect of a taxpayer's interest in a scheme within the four year holding period and even when that interest was acquired prior to the introduction of those sections. For example, when there is a subsequent collapse within the four year period of a managed investment scheme set up in the 2006 income year, investors will lose deductions in relation to these schemes and be assessed on the market value of the proceeds received, if any, as a result of the collapse of the scheme. A capital loss may, however, be available if the proceeds are less than the initial amount contributed to the scheme.

15. Note, however, as set out in paragraph 5 of this Determination, the Government has announced that the law in relation to the four-year holding rule is to be changed.

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## **Appendix 2 – Your comments**

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16. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

17. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au)

Please advise if you do not want your comments included in the edited version of the compendium.

<b>Due date:</b>	<b>27 November 2009</b>
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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- advance expenses & payments
- afforestation expenses
- forest operations
- forestry
- prepayments
- primary production

*Legislative references:*

- ITAA 1936 82KZMG
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- ITAA 1936 82KZMGA

- ITAA 1936 82KZMGB

- ITAA 1997 8-1

- ITAA 1997 Div 394

*Other references:*

- Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Act 1997
- Sherry, N (Assistant Treasurer), Government to Provide Tax Certainty to Investors in Forestry Managed Investment Schemes, media release No. 074, Canberra, 21 October 2009

ATO references

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