

PR 2001/43 - Income tax: Queensland Pine Forests No. 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *18 April 2001*



Product Ruling

Income tax: Queensland Pine Forests No. 2

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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.

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.

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 arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as Queensland Pine Forests No. 2, the Queensland Pine Forests No. 2 Project, or just simply as 'the Project' or the 'product'.

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 of the ITAA 1997;
 - section 27-5 of the ITAA 1997;
 - section 27-30 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM of the ITAA 1936;
 - section 82KZMA of the ITAA 1936;
 - section 82KZMB of the ITAA 1936;
 - section 82KZMC of the ITAA 1936;
 - section 82KZMD of the ITAA 1936;
 - section 82KZME of the ITAA 1936;
 - section 82KZMF of the ITAA 1936; and
 - Part IVA of the 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 it.

Qualifications

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

10. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

11. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

12. This Ruling applies prospectively from 18 April 2001, the date this Ruling is made. However, the Ruling does not apply to tax payers 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 & 22 of the 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, the Product 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 change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

15. The arrangements that are the subject of this Ruling are described below. The relevant documents or parts of documents incorporated into this description of the arrangements are:

- Queensland Pine Forests No. 2 Application for Product Ruling dated 22 December 2000, and annexures, including the following:
- Draft Prospectus for Queensland Pine Forests No. 2 dated 22 December 2000 prepared by GRO Securities Ltd ('GROSL', 'Manager' or 'the Responsible Entity');
- Scheme Constitution for Queensland Pine Forests No. 2 undated; incorporating Queensland Pine Forests Deed Poll;
- **Forest Management Agreement between GROSL and GROSL as agent for the Grower undated;**
- Draft Forestry and Administration Services Agreement between GROSL and Greenfield Resource Options Pty Ltd (as the Plantation Manager) undated;
- Compliance Plan for Queensland Pine Forests Managed Investment Scheme adopted by GRO Securities Limited undated;
- Custody Agreement between the Public Trustee of Queensland ('Custodian') and GROSL dated 17 March 2000;
- Variation to Custody Agreement between the Public Trustee of Queensland ('Custodian') and GROSL undated;
- Lease between Hyne and Son Investments (Lessor) and The Public Trustee of Queensland (Lessee) dated 4 April 2000;
- **Draft Deed of Licence to Occupy to be executed by GROSL as agent for the Grower and the Custodian dated 21 December 2000;**
- Draft Off-take Agreement between GROSL as agent for the Growers and Hyne & Son Pty Ltd undated;
- Constitution of GRO Securities Limited adopted on 11 October 1999;
- Draft Plantation Unit Plan;

- Supporting cash flow projections and claims provided with the application by the Responsible Entity;
- Letter from applicant dated 8 December 2000;
- Letter from applicant's representative dated 6 December 2000;
- Various external sourced documentations to support the application for discretion under the Non Commercial Loss Provisions;
- Other correspondence received from the agent for the Applicant dated 12 February 2001, 19 February 2001 and 6 March 2001.

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 that the 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 associate 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. Participation in the Queensland Pine Forests No. 2 project will enable an applicant to become a commercial Grower of timber through the licensing of Plantation Units. Softwood forest plantations will be established at 'Coolalbin' for the purpose of selling and supplying timber, with the final harvest being in approximately year 24 of the project. The Project will commence on a date specified by GRO Securities Limited (GROSL) but, subject to the minimum subscription requirements being met, no later than 15 June 2001.

18. Applicants will appoint GROSL to establish, maintain and harvest a pine plantation in accordance with the Forest Management Agreement. The Constitution sets out the terms and conditions under which GROSL agrees to act for the applicants (Growers) and to manage the project.

19. The right of the Grower to occupy the Plantation Unit is secured through the Head Lease between Hyne and Son and the custodian, the Public Trustee of Queensland. Each Grower will enter into a Licence to Occupy with the custodian. The Licence to Occupy will allow Growers access to Plantation Units for the purpose of conducting the afforestation business over the term of the project. Each Plantation Unit will be identified on a plantation map and

growers will be given a copy of the plantation map, detailing the location of their Plantation Units.

20. On the completion of planting, each Plantation Unit will consist of a planted area of 1 hectare (2.4 acres) planted with approximately 1,111 Pine trees. Growers are required to subscribe for a minimum of 2 Plantation Units.

21. The offer under this Prospectus expires on 15 June 2001 i.e., no applicants will be accepted into the Project after that date. A maximum of 500 Plantation Units are available under this Prospectus. The minimum subscription for the project to proceed has been set at 60 Plantation Units. If minimum subscription is not reached by 15 June 2001 Growers' applications will not be accepted and the Manager will return application monies to applicants as soon as reasonably possible.

Salient features of the arrangement

22. Salient features of the arrangement are as follows:

Name used to describe the arrangement:	Queensland Pine Forest No. 2 Project
Property location	Property known as "Coolalbin" situated in Gin Gin, Queensland.
Type of Business Each Participant is Carrying on	Each grower will be commercially growing hybrid Pine Trees namely <i>Pinus eliottii</i> (slash pine) and <i>Pinus caribaea</i> (Carribbean pine), for harvest and sale to timber processors.
Number of hectares under plantation:	Maximum of 500 hectares (ha) (500 x 1ha plantation units).
Number of trees per hectare:	approximately 1,111
Minimum subscription	60 plantation units
Minimum number of plantation units per grower	2
Term of the plantation:	24 years
Management Fee for the period to 30 June 2001 per hectare:	\$948
Licence Fee and Management Fee for the period to 30 June 2002 per hectare:	\$1,352

Ongoing yearly management and maintenance fees:	\$263 commencing Y3 and adjusted for CPI annually. Reviewed by Independent Forester every 5 years.
Ongoing yearly Licence to Occupy Fee:	\$184.80 commencing Y3 and adjusted for CPI annually.
Additional Costs	Extra expenses incurred in protecting economic value of Plantation Units will be subject to review by Independent Forester and will be passed on to Grower in the following financial year. Additional expenditure to enhance realisable value may also be recommended which would be subject to Grower approval.
Cost of Harvest access roads	Estimated to be \$126.50, \$244.20 and \$346.50 in years 9, 17 and 24 respectively paid from gross timber proceeds.
Custodian Fee	0.44% (GST inclusive) of gross timber proceeds in years 9, 17 and 24.
Harvest Management fee	5.5% (GST inclusive) of the gross timber proceeds in years 9, 17 and 24.

Expected production

23. Expected production per plantation unit is as follows:

Year and operation	Projected volume	Products
Year 9 Thinning	61m ³	Pulpwood Round wood for treated posts
Year 17 Thinning	138m ³	Pulpwood Round wood for treated posts Sawlogs
Year 24 Final harvest	319m ³	Pulpwood Poles and Sawlogs
Total	518m ³	

Total production on full plantation is forecast to be 259,000m³.

Sales

24. On behalf of the Growers, GROSL will sign an Off-take Agreement with Hyne and Son Pty Ltd. The Off-take Agreement provides that Hyne and Son Pty Ltd will purchase all pine trees at each thinning and final harvest from the Plantation Units. The market price for pine trees will be set at the time of each thinning and final harvest according to a market based formula outlined in the Off-take Agreement.

25. The purchaser is responsible for all harvest costs except harvest access roads. GROSL will deduct the harvest management fee, the custodian fee and cost of access roads from the gross harvest proceeds before distribution to the growers. Net proceeds will be held in the relevant proceeds fund by the Custodian for a maximum period of 90 days from the date of final payment from the purchase under the Off-Take Agreement. At this time the Manager is required to provide a certified Statement to each Grower reconciling the net proceeds paid to them.

Fees

26. Growers will receive a Licence to Occupy one hectare of land for a term of 24 years for each Plantation Unit acquired. An annual licence fee is payable.

27. After signing the Licence to Occupy Agreement, Growers will enter into the Forestry Management Agreement to develop, establish and maintain the plantation over the period of the licence. Management Fees are payable under this agreement.

28. Application fees payable under the Licence to Occupy, and Forestry Management Agreements for each Plantation Unit of one hectare are:

Year 1 - management fee payable on application

29. Payment for plantation establishment has been split over two years to fit with the timing of operations. A Management Fee of \$948 per Plantation Unit to cover portion of the plantation establishment costs is payable on application. All application monies will be deposited into a trust account held by the Custodian known as "Queensland Pine Forests No. 2 Project Application Account". No payments will be made from this account until the conditions for the release of the money have been fulfilled to the satisfaction of both GRO Securities and the Custodian in accordance with the Custody Agreement and the Forest Management Agreement. Subject to meeting the minimum subscription requirements the project must commence by 15 June 2001, and no applications will be accepted after

that date. All services covered by the application money will be completed by 30 June 2001.

Year 2: management fee payable by 31 October 2001

30. A Management Fee of \$1,172 to cover the balance of the planting and establishment costs is payable by 31 October 2001.

Years 3-24: management fee payable by 31 July each year

31. The Management Fee for year 3 is \$263 per Plantation Unit and subject to adjustment annually up to and including year 5 for any increase in CPI

32. Thereafter the Management Fee is reviewed and fixed every five years. In the event of any increase in the Management Fee being greater than the increase in CPI for the corresponding period, such increase will be reviewed by the Independent Forester and the Independent Forester will report on the reasonableness of any increase. Growers will be notified by 30 June of the Management Fee payable in the following financial year. These fees are payable in advance by 31 July in the financial year to which they apply. If due to events beyond GRO Securities' control extra expenses are incurred in protecting the economic value of the Plantation Units on behalf of growers then GRO Securities is entitled to pass such costs on to growers in the following financial year. The reasonableness of such costs is subject to review by the Independent Forester and will be reported to Growers. GRO Securities may from time to time recommend additional expenditure where it will enhance the realisable value of the Pine trees. GRO Securities will not incur this type of expenditure without the approval of Growers.

Years 2-24: licence to occupy payable

33. Each Grower enters into a Deed of License to Occupy with the Custodian. The Licence to Occupy will allow Growers access to their Plantation Unit for the purpose of conducting the business throughout the term of the project. The Grower shall not permit anyone else to use the land and retains the right to say when the trees are to be planted. The land can only be subleased or disposed of with the Licensor's approval

34. The licence runs for 24 years from 15 June 2001. The initial licence fee has been set at \$180 per Plantation Unit and is payable on 31 October 2001. The payment covers the period from the acceptance of the Grower's application to 30 June 2002. Thereafter the licence fee is payable in advance by 31 July of each financial year. The

licence fee will be adjusted each year as at 30 June to reflect any increase in CPI according to the formula set out in the Licence to Occupy.

35. If the Grower defaults in the payment of fees, the Licensor can take possession of the land. If the Grower breaches any conditions, the Licensor may enter the land to remedy the breaches at cost to the Grower.

36. Growers can elect to ensure their Plantation Units against loss from fire or windstorm. If the trees are destroyed and insurance proceeds obtained but not used for replanting, the Licence to Occupy may be cancelled and no further obligations exist. The premiums associated with this insurance are an additional cost of plantation ownership and are not covered by this Ruling.

Harvest management fee

37. A Harvest Management Fee of 5.5% (GST inclusive) of gross timber proceeds received from thinning and clear fell of trees from each Plantation Unit is charged by the Manager. The Manager shall deduct these fees from gross harvest proceeds prior to distribution to Growers.

Harvest access roads

38. It is estimated that the cost of harvest access roads will be:

Year	Cost per Plantation Unit of one hectare
9	\$126.50
17	\$244.20
24	\$346.50

The Manager shall deduct these fees from gross harvest proceeds prior to distribution to Growers.

Custodian fees

39. The Custodian is entitled to be paid 0.44% (GST inclusive) of gross timber proceeds. The Manager shall deduct these fees from gross harvest proceeds prior to distribution to Growers

40. The duties of the custodian include:

- Holding the assets of the project;
- Maintaining bank accounts to hold application monies, rents and other income and issuing cheques;
- Entering into leases of the properties.

Compliance Plan

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

The Constitution

42. The Constitution sets out the terms and conditions under which GROSL agrees to act for the Growers and to manage the project. Growers are bound by the Constitution by virtue of their acceptance into the project.

43. The Grower will complete a Power of Attorney to allow GROSL to enter into the agreements on the Grower's behalf and to execute and deliver the agreements.

44. The Manager has the sole discretion to determine whether to accept or reject all applications. Where an application has been rejected, the Manager must give written notice to the Applicant within a reasonable time after receipt of the application. The Manager must within a further 10 business days after notice of rejection is given, refund to the Applicant the application monies [cl 3.10]. Once an Application is accepted, the Manager must enter the Applicant on the Register as a Member [cl 3.12]. However the project cannot commence until the minimum subscription requirements have been met.

45. At the conclusion of the Arrangement, the Manager has 180 days to sell all of the cut timber and pass on the net harvest proceeds, after deducting the harvest management fee, harvest access roads fee and the custodian fee, to the Growers. Anytime before the final harvest, Growers may transfer any of their interest in the project subject to the conditions set out in Clauses 13 and 14 of the Constitution.

Forestry Management Agreement

46. A Forestry Management Agreement will be entered into between GROSL and each Grower. Growers will contract with GROSL, as Manager, to establish and maintain the Grower's Plantation Unit until maturity. The Manager shall use all reasonable endeavours to complete the following works in accordance with good forestry practices in respect of the leasehold property. GROSL may delegate its responsibilities.

47. Under the Farm Management Agreement GROSL will arrange for the following work to be performed.

Work to be done in year 1 – by 30 June 2001

48. GROSL shall arrange for the following work to be performed between 15 June 2001 and 30 June 2001:

- allocation;
- planning – development of management plan for establishment operations;
- preparation works;
- supplying hybrid *Pinus elliotti*/*Pinus caribea* seedlings at an average rate of 1,111 per hectare;
- report to Growers

Work to be done in year 2 - (2001/2002):

- application of fertiliser to seedlings;
- pre-planting weed control treatments as required;
- post planting weed control treatments as required;
- engage and fulfil Independent Forester's fees and expenses;
- obtain public liability risk insurance of \$10,000,000;
- treatment of regrowth;
- weed and pest control treatments as required;
- planting hybrid *Pinus elliotti*/*Pinus caribaea* seedlings at an average rate of 1,111 per Hectare;
- folia analysis of planted stock;
- fire control operations as required;
- general maintenance.

Work to be done in years 3 to 8 (2002/03 to 2007/08):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising, as required.

Work to be done in year 9 – first thinning (2008/09):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required;
- development of access roads to enable removal of harvest material;
- arrange harvesting of timber and delivery to purchaser under Off-Take Agreement;
- scheduling of harvest operations;
- management of environmental compliance;
- arrange services of custodian and payment for same.

Work to be done in year 10 to 16 (2009/10 to 2015/16):

- fertilisation in Year 10;
- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.

Work to be done year 17 – second thinning (2016/17):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required;
- development of access roads to enable harvest;
- arrange harvesting of timber and delivery to purchaser under Off- Take Agreement;
- scheduling of harvest operations;
- management of environmental compliance;
- arrange services of custodian and payment for same.

Work to be done in years 18-23 (2017/18) – (2022/23):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required.

Work to be done in year 24 – final harvest (2023/24):

- general maintenance, including attention to regrowth, access roads and firebreaks, pest control, environmental compliance, fertilising as required;
- development of access roads to enable harvest;
- arrange harvesting of timber and delivery to purchaser under Off-Take Agreement;
- scheduling of harvest operations;
- management of environmental compliance;
- arrange services of custodian and payment for same.

Sundries:

- crop, fire and wind insurance is the responsibility of the Grower; and
- GROSL will arrange public risk insurance for period from commencement of the Project to Year 24 to the value of \$10,000,000.

Projected returns

49. Growers should carefully read the Prospectus regarding projected returns from the project.

Finance

50. Growers may fund the cost of their plantation themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is involved in the provision of financing for the Project.

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

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project are or become involved in the provision of the finance;
- indemnity arrangements, or equivalent collateral arrangements limiting the borrower's risk;
- non-arm's length terms and conditions;
- additional benefits, for the purposes of section 82KL, are granted to borrowers, or the funding arrangement

transforms the Project into a 'scheme' to which Part IVA may be applied;

- repayments of principal and payment of interest are linked to derivation of income from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Scheme, but are transferred (by any means, and directly, or indirectly), back to the lender, or any associate; or
- lenders do not have the capacity under the loan agreement, or do not have a genuine intention, to take legal action against defaulting borrowers.

Ruling

Assessable income

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

Minimum subscription

53. A Grower will not incur the fees shown in the Tables below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). The minimum subscription of 60 Plantation Units must be achieved by 15 June 2001. Tax deductions are not allowable until these requirements are met. If the Project's minimum subscription requirements (described above) are reduced or altered in any way (for example, through the issue of a supplementary prospectus), this Product Ruling, including the deductions it describes, will have no application to any Grower. In such a case, Growers who are considering an investment in the Project should ensure that the Responsible Entity has obtained a new Product Ruling describing the changed arrangement.

Section 8-1

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

54. A Grower who invests in the Project and is accepted into the Project by 15 June 2001, the deductions shown in the Table below

will be available for the years ended 30 June 2001 to 30 June 2003 provided the Grower:

- participates in the Project by 15 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 29 to 36; and
- is not registered nor required to be registered for GST.

Expenses	Legislation ITAA 1997	30/6/2001	30/6/2002	30/6/2003
Management Fee	8-1	\$948	\$1172 See Note (i) and (ii) below	\$263 See Note (i) and (ii) below
Licence Fees	8-1	0.00	\$180* See note (i) below	\$184.80* See note (i) below
Interest	8-1	As incurred See note (ii) below	As incurred See note (ii) below	As incurred See note (ii) below
Total		\$948	\$1352	\$447.80

* Subject to increase in line with CPI rises

Notes:

- (i) Where a Grower incurs the management fees and licence fees as required by the Management Agreement those fees are deductible in full in the year incurred provided the services are performed in that same year. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or for the licence fee) that will not be wholly done in the same income year as the fees are incurred, then the prepayments 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 74 to 82 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. A deduction under section 8-1 is allowed in the year in which the expenditure is incurred and the services which pertain to the fee are provided.

- (ii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 101 to 103 below as those rules may be applicable if interest is prepaid. Deductions where a Grower is registered or required to be registered for GST.

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

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

- participates in the Project by 15 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraphs 29 to 36; and
- is entitled to an input tax credit for the fees

then the tax deductions calculated using the method and Table in paragraph 54 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 105.

Deferral of losses from non-commercial business activities

Section 35-55 - Commissioner's discretion

56. 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 his/her involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for a Grower who has two or more Plantation Units that for the income years ending 30 June 2001 to 30 June 2008 inclusive 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.

57. 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 90 in the Explanations part of this ruling, below).

58. 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 his/her 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.

59. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

Sections 82KZM, 82KZMB – 82KZMD and 82KZME – 82KZMF

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

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 74 to 82);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 74 to 82); and
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 74 to 82).

Section 82KL

61. Section 82KL does not apply to deny the deduction otherwise allowable.

Part IVA

62. 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 8-1**

63. Consideration of whether the Licence to Occupy and Forestry Management Fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing 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 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.

Is the Grower carrying on a business?

64. An afforestation arrangement can constitute the carrying on of a business. Where there is a business, or a future business, the gross harvest proceeds from timber sales from the arrangement will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the trees.

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

- the Grower has an identifiable interest in specific Plantation Units coupled with a right to harvest and sell the timber;

- the afforestation activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

66. For this Project Growers have, under the Licence to Occupy and Forestry Management Agreement, rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing trees. Under the Licence to Occupy and Forestry Management Agreement Growers appoint GROSL, as Responsible Entity, to provide services such as planting, cultivating, tending, culling, pruning, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. Growers are considered to have control of their investment. Growers have a guaranteed market for sale through the Off-Take Agreement with Hyne and Son Pty Ltd.

67. The Licence to Occupy and Management Forestry Agreements gives Growers full right, title and interest in the Forest Produce and the right to have the Pine Trees sold for their benefit (clause 6 – Forestry Management Agreement). The relevant documentation contemplates that Growers will have an ongoing interest in the growing trees. The trees situated on each Plantation Unit of one hectare acquired by a Grower belong to the Grower. The Growers have an interest in the land on which they are growing through the Licence to Occupy. Growers are entitled to receive income from the sale of their produce, the price of which is determined by the pooling of their interests with other Growers.

68. Growers have the right to use their Plantation Unit for afforestation purposes and to have GROSL come onto the land to carry out its obligations under the Forestry Management Agreement. The Growers' degree of control over GROSL, as evidenced by the Agreement, and supplemented by the Corporations Law, is sufficient. Under the arrangement documentation, Growers are entitled to receive regular progress reports on GROSL's activities. Growers are able to terminate arrangements with GROSL in certain instances, such as cases of default or neglect. The afforestation activities described in the Licence to Occupy and Forestry Management Agreement are therefore carried out on the Growers' behalf.

69. 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 arrangement is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the arrangement. This intention is related to projections contained in the Prospectus that suggest the arrangement 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.

70. 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.

71. 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.

72. The fees associated with the afforestation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of timber) is to be gained from this business. They will 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 arrangement. The fee appears to be reasonable. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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

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

74. 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 of the ITAA 1997. The section applies to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

75. Under the Forestry Management Agreement a fee of \$948 per Plantation Unit will be incurred on execution of the Agreement. This fee is charged for providing services to a Grower during the period from 15 June 2001 to 30 June 2001. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

76. 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 doing 'things' that are not to be done within the year of income of the fee being incurred.

77. Subsequent fees due under the Forestry Management Agreement and the Deed of Licence to Occupy indicate that the services to be provided are to be completed in the same year of income or partly a prior year of income and partly in the same year of income (in relation to the initial Licence Fee) as the expenditure is incurred. Accordingly the basic precondition for the operation of the prepayment provisions is not satisfied and both the initial Management Fees and subsequent Management and Licence Fees will be deductible in the year they are incurred.

78. Although not required under the Arrangement described in this Product Ruling, where a Grower participating in this Project incurs expenditure in respect of the doing of things (e.g., the performance of management services, the payment of licence fees or the lending of money), prior to the commencement of the eligible service period, the prepaid expenditure is not deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are 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'.

79. The amount and timing of deductions for any prepaid Management Fees and Licence Fees otherwise deductible under section 8-1 will depend on 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..

80. 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.

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

81. 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 84 to 86) 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 80 above, concerning section 82KZMF.

82. A prepaid management fee and/or a prepaid lease 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 management fee or a licence fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Section 82KL

83. The operation of section 82KL 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. It will not apply to deny the deduction otherwise allowable under section 8-1.

Small business taxpayers

84. 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.

85. '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).

86. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

Division 35 - losses from non-commercial business activities

87. 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.

88. 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.

89. 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.

90. 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.

91. 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).

92. 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 two Plantation Units is unlikely to pass one of the objective tests until the income year ended 30 June 2024. Growers who acquire more than two Plantation Units in the Project may, however, pass one of the tests in an earlier income year.

93. 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.

94. 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 income years ending 30 June 2001 to 30 June 2008.

95. 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.

96. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above, in the manner described in the Arrangement section, 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.

97. 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.

98. In deciding to exercise his discretion the Commissioner relies upon any and all information provided in respect of the Arrangement. Including:

- the report of the independent expert or scientific evidence provided with the application by the Responsible Entity;

- the binding off-take agreement between the Responsible Entity and Hyne and Son Pty Ltd for the sale of the timber setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the timber is grown; and
- supporting cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Part IVA

99. For Part IVA to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the Scheme to obtain a tax benefit (section 177D). The Project will be a ‘scheme’ commencing generally on the date when the Prospectus was issued. The Growers will obtain a ‘tax benefit’ from entering into the arrangement, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for the arrangement. 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.

100. Growers to whom this Ruling applies intend to stay in the arrangement for its full term and derive assessable income from the eventual harvesting of the trees. Furthermore, there are no features of the Projects, for example, such as the Licence to Occupy and Forestry 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 arrangement was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Interest deductibility

101. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier 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.

102. 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. Under the prepayment rules contained in sections 82KZME, ‘agreement’ (defined in subsection 82KZME(4)) is a broad concept

and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

103. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for a more than 13 months, any tax deduction that may be allowable 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 80 above.

Section 82KL - recouped expenditure

104. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. 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.

Example

Example 1 – entitlement to ‘input tax credit’

105. 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’ showing its ABN and the ‘value of the taxable supply’ for management services as \$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

18 April 2001

<i>Previous draft:</i>	- ITAA 1997 35-10(4)
Not previously issued in draft form	- ITAA 1997 35-30 - ITAA 1997 35-35
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-40
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1997 35-45
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 35-55(1)
PR 1999/95	- ITAA 1997 35-55(1)(a) - ITAA 1997 35-55(1)(b)
<i>Subject references:</i>	- ITAA 1997 960-335
- carrying on a business	- ITAA 1997 960-340
- commencement of business	- ITAA 1997 960-345
- fee expenses	- ITAA 1997 960-350
- interest expenses	- ITAA 1936 82KL
- management fees expenses	- ITAA 1936 82KZL(1)
- producing assessable income	- ITAA 1936 82KZM
- product rulings	- ITAA 1936 82KZM(1)
- public rulings	- ITAA 1936 82KZMA
- schemes and shams	- ITAA 1936 82KZMA(4)
- taxation administration	- ITAA 1936 82KZMB
- tax avoidance	- ITAA 1936 82KZMC - ITAA 1936 82KZMD - ITAA 1936 82KZMD(2)
<i>Legislative references:</i>	- ITAA 1936 82KZME
- ITAA 1997 6-5	- ITAA 1936 82KZME(4)
- ITAA 1997 8-1	- ITAA 1936 82KZME(7)
- ITAA 1997 17-5	- ITAA 1936 82KZMF
- ITAA 1997 Div 27	- ITAA 1936 82KZMF(1)
- ITAA 1997 27-5	- ITAA 1936 Pt IVA
- ITAA 1997 27-30	- ITAA 1936 177A
- ITAA 1997 Div 35	- ITAA 1936 177C
- ITAA 1997 35-10	- ITAA 1936 177D
- ITAA 1997 35-10(2)	
- ITAA 1997 35-10(3)	

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