

PR 2004/58 - Income tax: Willmott Forests Professional Investor - 2004 Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *7 December 2005*



Product Ruling

Income tax: Willmott Forests Professional Investor – 2004 Project

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Preamble

*The number, subject heading, **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.*

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

No guarantee of commercial success

Potential participants 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.

The Australian Taxation Office (ATO) **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. 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 product fits an existing portfolio, etc. 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 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the tax law(s) 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 the 'Willmott Forests Professional Investor – 2004 Project' or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Section 82KZL (ITAA 1936);
 - Sections 82KZME – 82KZMG (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. All fees and expenditure referred to in this 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.

Changes in the Law

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

5. Taxpayers who are considering participating 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 participants in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that potential participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is 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, each of these persons, referred to as 'Growers', will be 'wholesale clients' for the purposes of section 761G of the *Corporations Act 2001*.

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;
- persons who elect to opt out of the marketing and harvesting arrangement with Willmott Forests Limited and organise the harvesting and marketing of timber produced from their 'Hectares';
- persons who choose to pay by transferring property to the Manager, as set out in clause 4.2 of the Investment Deed of the Willmott Forests – Professional Investor – 2004 Project;
- persons who participate in the Project through offers made other than through the Information Memorandum;

- Willmott Forests Limited or its associates; and
- persons who are accepted to participate in the Project after 30 June 2005.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. 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. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 19 May 2004, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. 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 commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Note: The Addendum to this Ruling that issued on 7 December 2005, applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. 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 arrangement specified below. 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

14. The arrangement that is the subject of this Ruling is specified below. This arrangement incorporates the following documents:

- Application for a Product Ruling dated 26 April 2004, as constituted by documents provided on 30 March 2004 and additional correspondence (including e-mails) dated 5 April 2004; 22 April 2004 and 27 April 2004;
- Draft Willmott Forests Professional Investor – 2004 Project Information Memorandum issued by Willmott Forests Limited ('WFL', the 'Manager' and the 'Responsible Entity') dated 9 March 2004, received by the Tax Office on 30 March 2004 ('Information Memorandum');
- Draft Investment Deed of the Willmott Forests – Professional Investor – 2004 Project ('Investment Deed') issued by WFL dated February 2004, received by the Tax Office 30 March 2004;
- Proforma **Lease Agreement** between WFL and the Grower received by the Tax Office on 30 March 2004 with amendments, provided on 22 April 2004;
- Proforma **Pre-lease Agreement** between WFL and the Grower, received by the Tax Office 30 March 2004;
- Proforma **Sub-lease Agreement** between WFL and the Grower, received by the Tax Office 22 April 2004;
- Proforma **Forestry Management Agreement** between WFL ('Manager') and the Grower, received by the Tax Office 30 March 2004;
- Draft Forestry Right Agreement ('Forestry Right') received by the Tax Office 30 March 2004, with amendments, provided on 22 April 2004; and

- Proforma **Loan Agreement** between Willmott Finance Pty Ltd ('Willmott Finance') and the Grower, received by the Tax Office on 30 March 2004.

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

15. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement 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 arrangement. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936.

16. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client. **This Ruling does not apply unless the Grower is a wholesale client for the purposes of in section 761G of the Corporations Act 2001.** The meaning of wholesale client is explained in the Information Memorandum for this Project.

17. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

18. The arrangement is called the Willmott Forests Professional Investor – 2004 Project and is summarised as follows:

Location	Areas of New South Wales, Victoria, South Australia and Queensland that meet land selection criteria set out in the report of the Independent Forester in the Information Memorandum.
Type of business to be carried on by each participant	Long term commercial plantations for the purpose of harvesting <i>Pinus radiata</i> .
Number of hectares offered for cultivation	Unlimited.
Size of each interest	Minimum of 72 'Hectares' or such other amount as the Manager may determine (but no less than 50 'Hectares').
Trees per hectare	1,100 seedlings.
Term of the Project	25 years.
Initial cost per hectare	\$7,700.

Ongoing costs	Maintenance and lease rental costs will be a percentage of 'Gross Timber Proceeds' from the 'Thinnings' and the 'Clear Fell' or from insurance proceeds in the event of 'Material Damage' to the 'Trees'.
Other costs	Compulsory insurance premiums from Year 6; Harvesting Fee, of 1% of 'Gross Timber Proceeds'; Interest payments, under the Loan Agreement; and Any other amounts agreed upon in writing between WFL and Growers.

19. The Project is an unregistered managed investment scheme under the *Corporations Act 2001*. The objective of the Project is to establish and manage long term commercial plantations of softwood for the purpose of harvesting for sale.

20. Under the Information Memorandum, applicants apply for 72 'Hectares' or such other amount as the Manager may determine (but no less than 50 'Hectares'). Applicants are accepted to participate in the Project as Growers and enter into a Lease or Sub-Lease Agreement and a Management Agreement with WFL. Where land is not immediately available for lease, Growers will also enter into a Pre-lease Agreement. The Project will be terminated after 'Clear Fell', a period of approximately 25 years.

Investment Deed

21. The Investment Deed establishes the Project and operates as a deed binding all the Growers and WFL. Growers are bound by the Investment Deed from the time of their acceptance into the Project.

22. The Investment Deed sets out the terms and conditions under which WFL agrees to act for the Growers and to manage the Project. Within 30 days of execution and delivery of an application for 'Hectares', WFL is required to notify an Applicant in writing of their acceptance in the Project. WFL has absolute discretion to decline or accept an Application for 'Hectares'. Where the application is accepted, the Manager has two months to place the Grower in the Register and provide the Grower with a copy of the Forestry Management Agreement and Lease or Sub-Lease Agreement.

23. Among other things, the Investment Deed sets out:
- the Application procedure (clause 4);
 - procedures for Payment (clause 5);
 - the Powers of the Manager (clause 6);
 - the Rights and liabilities of the Manager (clause 7);
 - the Liability of Growers (clause 9);
 - Remuneration and expenses of the Manager (clause 10);
 - the Stocking Guarantee (clause 12);
 - Insurance against damage by fire and public liability insurance (clause 13);
 - procedures for the harvest and sale of the Growers' 'Trees' (clause 14);
 - procedures for transfer and transmission of 'Hectares' (clause 15); and
 - the period of the Project (clause 17).

Forestry Management Agreement

24. A Forestry Management Agreement is entered into between WFL and each Grower. Growers contract with the Manager to establish and maintain the plantation until maturity. The Manager may delegate its responsibilities. The Manager will use all reasonable endeavours to carry out its obligations under Part 1 and Part 2 of Schedule 1 of the Forestry Management Agreement in accordance with good forestry practices.

25. Part 1 services are for 'Preparation and Planting' and will be provided to Growers within the first 12 months of the Grower being accepted to participate in the Project. This Product Ruling will not apply to any Grower where WFL fails to complete the services under Part 1 of Schedule 1 of the Forestry Management Agreement within 12 months of the Grower's acceptance into the Project.

26. Services under Part 2 of Schedule 1 of the Forestry Management Agreement are for 'Maintenance' and will be provided from the completion of the services under Part 1 of Schedule 1 of the Forestry Management Agreement to 'Clearfell' in Year 25.

27. The Part 1 and Part 2 services under Schedule 1 of the Forestry Management Agreement are as follows:

Part 1 preparation and planting

Year 1

- preparation works – ripping, mounding and/or ploughing;
- pre-planting weedicide treatments, as required;
- supply and planting *Pinus radiata* seedlings at a rate of 1100 per Hectare;
- fertilising, where required; and
- pest control.

Part 2 maintenance

Year 2

- supply and replanting of *Pinus radiata* seedlings, where required;
- treatment of regrowth;
- post-planting weedicide treatments, as required;
- folia analysis of planted stock;
- construction and maintenance of access roads and firebreaks, as required; and
- general maintenance inclusive of ongoing monitoring.

Year 3

- general maintenance including: monitoring, attention to regrowth, access roads and firebreaks and fertilising, where required.

Year 4

- general establishment work and maintenance including: monitoring, attention to regrowth, access roads and firebreaks.

General maintenance

Years 5 – 25

- further fertilising; and
- general maintenance including monitoring, attention to regrowth, access roads, firebreaks and selective pruning.

28. Under clause 2.3 of Part 2 the Manager will provide a 'Stocking Guarantee' for a period of 5 years (called the 'Stocking Guarantee Period') from the date the Grower is registered as the holder of 'Hectares' on the terms and conditions set out in clause 12 of the Investment Deed.

Lease or Sub-Lease Agreement and Forestry Right

29. A reference to 'Lease' or 'Lease Agreement' in the Product Ruling is a reference to 'Lease' or 'Sub-Lease' and 'Lease Agreement' or 'Sub-Lease Agreement' as applicable, entered into between the Grower and the Manager.

30. An unregistered lease is granted by WFL (the 'lessor') to each Grower (the 'lessee'). WFL also grants a Forestry Right over the project land to be held by Willmott Forests Investment Management Pty Ltd as agent of the Growers. The Forestry Right will be registered with the applicable land titles office and will provide protection for the Grower's leasehold interest in the event of future dealings in the Project land.

31. Under the Lease and Forestry Right Growers have an interest in land to use their 'Hectares' for the purposes of conducting their afforestation business, including the right to harvest timber grown on their 'Hectares'. The term of the lease is for 25 years and may be extended for a further term of 5 years or until such time as the 'Trees' have been harvested and the land made good, whichever is sooner. The lessee may use the land only as part of a managed investment scheme by which Growers, including the lessee, participate in the establishment and maintenance of 'Trees'.

Pre-lease Agreement

32. The pre-lease agreement is granted by WFL to the Grower upon acceptance of application where WFL is not immediately in a position to grant the Grower a lease (including the Forestry Right) in respect of the Grower's 'Hectares'. WFL undertakes to take all reasonable steps to grant a Lease and Forestry Right in respect of the Grower's 'Hectares' no later than 9 months from the date of acceptance of the Grower's application.

33. Where WFL has not been able to grant a Lease and Forestry Right to the Grower in respect of the Grower's 'Hectares' within 9 months then either party may terminate the agreement by providing 7 days prior written notice. WFL must (except in an event of default) refund any of the Grower's application monies paid in respect of the Application within 14 days of the receipt or service of the notice.

Fees

34. The total fee in consideration of the services under Part 1 of Schedule 1 of the Forestry Management Agreement is \$7,700 per 'Hectare' and is payable under one of the following payment options:

- a cash payment payable on application for a cost of \$7,700 per hectare; or
- under a Loan Agreement with Willmott Finance.

Note: Clause 4.2 of the Investment Deed also allows a Grower to make payment by transferring property to the Manager. Growers who make a payment by transferring property to the Manager will not be covered by this Product Ruling. Such Growers may apply for a private ruling on the tax consequences of their participation in the Project.

35. Under Part 2 of Schedule 1 of the Forestry Management Agreement Growers pay a fee for maintenance of 7% of the 'Gross Timber Proceeds'. This is to be paid by each Grower as and when the 'Trees' are thinned or clear felled, and sold. If the Grower receives payment under an insurance policy in respect of damage to, or destruction of, the Grower's 'Trees' on a Hectare, 7% of the insurance proceeds are to be paid to WFL within 14 days of their receipt.

36. Under the Lease Agreement the rent per 'Hectare' is an amount equal to 2% of the 'Gross Timber Proceeds' received from the harvesting of 'Trees' on each 'Hectare'. If the lessee receives payment under an insurance policy in respect of damage to, or destruction of, the lessee's 'Trees' on a Hectare, 2% of the insurance proceeds are to be paid to the lessor within 14 days of their receipt.

37. The Information Memorandum provides that unless the Manager has been notified otherwise, Growers who are accepted to participate in the Project engage the Manager to market and harvest their timber. Growers can elect to 'opt-out' of the marketing and harvesting arrangements for the Project and organise the harvesting and marketing of their own timber. Unless the Grower exercises this option, a Harvesting Fee totalling 1% of 'Gross Timber Proceeds' is payable for the Manager's fees and expenses.

38. The Manager will, in addition to any other rights it may have, be entitled to charge interest on amounts outstanding and terminate the Management and Lease or Sub-Lease Agreement for any amount that is not paid on or before the due date for payment. The Manager reserves the right to take any necessary legal action and the Grower agrees to indemnify the Manager for any costs or expenses it incurs in seeking to recover any unpaid application moneys.

Pooling of 'Trees' and distribution of proceeds

39. The Investment Deed (clause 14) and the Information Memorandum set out the circumstances relating to the pooling of Growers' 'Trees' and the distribution of proceeds from that sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed 'Trees' from a 'Harvested Hectare' to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and
- 'Trees' can only be pooled with the 'Trees' of Growers accepted to participate in the Project in the same financial year.

Application Form and Loan Agreement

40. Under the Application Form that forms part of the Information Memorandum, Growers who are accepted to participate in the Project grant WFL an irrevocable Power of Attorney. This allows WFL to execute and deliver the Pre-lease Agreement and/or Lease Agreement, the Forestry Management Agreement and, if applicable, the Loan Agreement ('Project Documents'). The Power of Attorney applies from the date of the Application being signed, to the expiration of the Project Documents.

41. The Application Form also provides Growers with an opportunity to elect to opt out of harvesting and marketing arrangements with the Manager. Growers who make this election will not be covered by this Product Ruling and may seek a private ruling on the tax consequences of participating in the Project.

42. Upon signing the Application Form a Grower who has not been approved to pay fees under a Loan Agreement acknowledges that the full fee for all Application Monies is immediately due and payable.

43. The Application Form provides that a Grower who elects to, and is accepted to pay the 'Application Monies' under the Finance Option is required to execute a 'Loan Agreement'. Under the 'Loan Agreement', a Grower declares that the terms for the payment of 'Moneys Owing' have been extended pursuant to the Application and that this agreement is supplementary to the Application.

44. The 'Loan Agreement' details the payments due where an Applicant is accepted to participate in the Project and payment by the Finance Option is approved by Willmott Finance. Under the Loan Agreement 'Moneys Owing' will be the balance of the fee payable under Part 1 of Schedule 1 of the Forestry Management Agreement, interest and all other moneys actually or contingently owing under the Application.

45. Under a 'Loan Agreement', payment under the Finance Option will be on a full recourse basis. If a Grower defaults, Willmott Finance will pursue the 'Moneys Owing' to the full extent permitted by law.

46. Application moneys paid to WFL at the time of a Grower's Application will be deposited into a trust account known as the Willmott Forests Professional Investor Project – Application Account and will only be released and paid to WFL once the Application is accepted.

Finance

47. Growers who do not pay the fee under Part 1 of Schedule 1 of the Forestry Management Agreement in full upon Application or, who do not receive approval to pay their fees under a 'Loan Agreement' with Willmott Finance, can fund their investment in the Project themselves, or borrow from an independent lender.

48. Financing arrangements, other than the 'Loan Agreement' with Willmott Finance set out below, are not covered by this Product Ruling. Growers who enter into other finance arrangements may request a private ruling on the deductibility or otherwise of interest incurred under the agreement.

49. Where a Grower enters into a 'Loan Agreement' with Willmott Finance a deposit of \$700 per hectare is payable at the time of the application and a 'part payment' of \$700 per hectare is payable within 90 days from the date of the Loan Agreement.

50. The balance of \$6,300 per hectare is financed under a 10 year interest only facility at 8.75% per annum. At the end of year 10, and subject to written consent being given by Willmott Finance before the end of year 10, the loan will revert to a 5 year principal and interest facility at 8.75% per annum.

51. Following acceptance of a Grower's application to participate in the Project ('Payment Date') payments of interest under the Loan Agreement are payable quarterly in arrears commencing on:

- 30 September 2004 for applicants accepted on or before 30 June 2004; and
- 30 September 2005 for applicants accepted on or before 30 June 2005.

52. Growers cannot rely on any part of this Product Ruling if Application Monies, other than Application Monies payable subject to a Loan Agreement, are not paid in full by 30 June of the income year in which the Grower is accepted to participate in the Project. Where an application is accepted by WFL subject to finance approval by any lending institution, including Willmott Finance, Growers cannot rely on this Ruling if written evidence of that approval has not been given to WFL by 30 June of the income year in which the Grower is accepted to participate in the Project.

53. This Ruling also does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Willmott Finance, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

54. This Ruling applies only to Growers who are wholesale clients for the purposes of in section 761G of the *Corporations Act 2001* and who are accepted to participate in the Project either as:

- a '**2004 Grower**' where the Grower has executed a Forestry Management Agreement and either a Pre-lease or a Lease or Sub-lease Agreement on or before 30 June 2004; and/or
- a '**2005 Grower**' where the Grower has executed a Forestry Management Agreement and either a Pre-lease or a Lease or Sub-lease Agreement on or before 30 June 2005.

55. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

56. This Ruling does **not** apply to Growers who:
- are excluded from the Ruling as described in the Class of Persons or in the Arrangement sections of this Project Ruling; or
 - are accepted to participate in the Project on or after 1 July 2005.
57. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

58. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. Changes to the STS rules apply from 1 July 2005. From that date, STS taxpayers may use the accruals accounting method or can continue to use the cash accounting method (called the 'STS accounting method' – see section 328-125).

Qualification

59. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Assessable Income

Sections 6-5 and 328-105

60. That part of the gross sales 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.
61. Other than Growers referred to in paragraph 62, a Grower is assessable on ordinary income from carrying on their business of afforestation in the income year in which that income is derived.
62. A Grower who is an 'STS taxpayer' continuing to use the cash accounting method is assessable on ordinary income from carrying on their business of afforestation in the year in which that income is received.

PR 2004/58**Deductions for the fee under Part 1 of Schedule 1 of the Forestry Management Agreement and for interest under a Loan Agreement with Willmott Finance**

63. [Deleted]

64. [Deleted]

Section 8-1 and section 328-105

65. A Grower may claim, on a per Hectare basis, tax deductions for the following revenue expenses.

For Growers who are accepted to participate in the project on or before 30 June 2004

Fee Type	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Part 1 Fee	\$7,700 See Notes (i), & (ii)	nil	nil
Interest Payable to Willmott Finance under a Loan Agreement	nil	As incurred (Non-STSTaxpayers); or as paid (STSTaxpayers) See Notes (iii) & (iv)	As incurred (Non-STSTaxpayers & STSTaxpayers using accruals accounting); or as paid (STSTaxpayers using cash accounting) See Notes (iii) & (iv)

For Growers who are accepted to participate in the project on or after 1 July 2004 and on or before 30 June 2005

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Part 1 Fee	\$7,700 See Notes (i), & (ii)	nil	nil
Interest Payable to Willmott Finance under a	nil	As incurred (Non-STSTaxpayers & STSTaxpayers using accruals	As incurred (Non-STSTaxpayers & STSTaxpayers using accruals

Loan Agreement		accounting); or as paid (STS taxpayers using cash accounting) See Notes (iii) & (iv)	accounting); or as paid (STS taxpayers using cash accounting) See Notes (iii) & (iv)
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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. See the Example at paragraph 107;
- (ii) The fee under Part 1 of Schedule 1 of the Forestry Management Agreement is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 91 to 97) and is deductible under section 8-1 in the income year in which it is incurred (where the Grower is **not an 'STS taxpayer'**) or the income year in which it is paid (where the Grower is an **'STS taxpayer'**) (paragraph 328-105(1)(b));
- (iii) Growers who enter into a Loan Agreement with Willmott Finance for payment of the fee under Part 1 of Schedule 1 of the Forestry Management Agreement will incur interest quarterly in arrears, as set out in the Agreements.
- Where the Grower is **not an 'STS taxpayer'**, such interest is deductible in the income year in which it is incurred.
- For the 2003-04 and 2004-05 income years, such interest is deductible in the income year in which it is paid (where the Grower is an **'STS taxpayer'**).
- For the 2005-06 and 2006-07 income years, such interest is deductible in full in the year that it is incurred (where the Grower is an **'STS taxpayer' using the accruals accounting method**) or in the year it is paid (where the Grower is an **'STS taxpayer' continuing to use the cash accounting method**); and
- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Willmott Finance is outside the scope of this Ruling. Growers who borrow from lenders other than Willmott Finance may request a private ruling on the deductibility of the interest incurred.

Deferral of losses from non-commercial business activities Division 35

Section 35-55 – Commissioner's discretion

66. A Grower who is an individual accepted into the Project as a '2004 Grower' or a '2005 Grower' 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 above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2004 to 30 June 2029** (for '2004 Growers') or **30 June 2005 to 30 June 2030** (for '2005 Growers'). 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.

Sections 82KZME to 82KZMF, 82KL and Part IVA

67. For a Grower who participates in the Project and incurs expenditure as required by the Forestry Management Agreement, the Lease Agreement and any Loan Agreement (as applicable) the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME to 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.

Explanation

Is the Grower carrying on a business?

68. For the amounts set out in the Table to constitute allowable deductions the Grower's afforestation activities as a participant in the Willmott Forests Professional Investor – 2004 Project must amount to the carrying on of a business of primary production.

69. Where there is a business, or a future business, the gross proceeds from the sale of the 'Trees' from the 'Hectares' 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.

70. For schemes such as that of the Willmott Forests Professional Investor – 2004 Project, 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 *FCT v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

71. Generally, a Grower will be carrying on a business of afforestation, and hence primary production, if:

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

72. In this Project, each Grower enters into a Forestry Management Agreement, a Lease Agreement, a Sub-lease Agreement and a Forestry Right Agreement (as necessary).

73. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of a minimum of 50 'Hectares' of land. The Lease Agreement provides the Grower with an ongoing interest in the specific 'Trees' on the leased area for the term of the Project. Under the Lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Lease allows the Manager come onto to the land to carry out its obligations under the Forestry Management Agreement.

74. Under the Forestry Management Agreement the Manager is engaged by the Grower to establish and maintain the 'Hectares' of the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the 'Hectares' on the Grower's behalf.

75. The Manager is also engaged to harvest and sell, on the Grower's behalf, the 'Trees' grown on the Grower's 'Hectares'.

76. 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.

77. 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 the 'Trees' that will return a before-tax profit, i.e. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

78. The pooling of 'Trees' grown on the Grower's 'Hectares' with the 'Trees' of other Growers in the Project is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled 'Trees' will reflect the proportion of the 'Trees' contributed to the pool from their 'Hectares'.

79. The Manager's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses.

80. The Grower's degree of control over the Manager as evidenced by the Information Memorandum, Forestry Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's 'Hectares' and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

81. 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 Willmott Forests Professional Investor – 2004 Project will constitute the carrying on of a business.

The Simplified Tax System ('STS')

Division 328

82. 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.

83. 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 fees under Part 1 of Schedule of the Forestry Management Agreement**Section 8-1**

84. Consideration of whether fees under Part 1 of Schedule 1 of the Forestry Management Agreement 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 is contractually committed 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.

85. The management fee payable under Part 1 of Schedule 1 of the Forestry Management Agreement is associated with the afforestation activities and will relate to the gaining of income from the Grower's business of afforestation, and hence have a sufficient connection to the operations by which income (from the harvesting and sale of the 'Trees' 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. There is no capital component of the initial management fee. The tests of deductibility under the first limb of section 8-1 are met (subject to the provisions of section 82KZMG). The exclusions do not apply.

Interest deductibility**Section 8-1**

(i) Growers who pay fees under a Loan Agreement with Willmott Finance

86. Some Growers may finance their participation in the Project through a Loan Agreement with Willmott Finance. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the fees under Part 1 of Schedule 1 of the Forestry Management Agreement.

87. The interest incurred will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of 'Trees' – that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1. A Grower who is an 'STS taxpayer' (for the year ending 30 June 2005) or who is an 'STS taxpayer continuing to use the cash accounting method (for the years ending 30 June 2006 and 30 June 2007) can, therefore, claim a deduction for interest in the income year in which the amount is paid, or paid on their behalf (paragraph 328-105(b) and section 328-120). All other Growers can claim a deduction for interest in the income year in which the interest is incurred.

(ii) Growers who enter into finance arrangements with other finance providers

88. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance facility with a bank or financier other than Willmott Finance 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.

Prepayment provisions

Sections 82KZL to 82KZMG

89. 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.

90. For this Project, only section 82KZL (an interpretive provision) and section 82KZMG are relevant.

Section 82KZMG

91. Under section 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

92. Subsection 82KZMG(2) requires that the expenditure is
- incurred on or after 2 October 2001 and on or before 30 June 2006;
 - the eligible service period must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year; and
 - for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

93. To satisfy subsection 82KZMG(3) the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling;
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (a right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and
- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

94. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling.

95. Subsection 82KZMG(5) defines the 'establishment period to commence at the time that the first 'seasonally dependent agronomic activity' is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

96. Under Part 1 of Schedule 1 of the Forestry Management Agreement, a Grower incurs a fee consisting of expenditure of \$7,700 per Hectare for 'seasonally dependent agronomic activities'.

97. As this expenditure meets the requirements of section 82KZMG a Grower who is not an 'STS taxpayer' can claim an immediate deduction for the fee under Part 1 of Schedule 1 of the Forestry Management Agreement in the income year in which the amount is incurred. A Grower who is an 'STS taxpayer' can claim an immediate deduction for the fee under Part 1 of Schedule 1 of the Forestry Management Agreement in the income year in which the fee is paid, or paid on behalf of the Grower.

Sections 82KZME and 82KZMF

98. Under the Arrangement to which this Product Ruling applies fees for rent under the Lease Agreement and fees under Part 2 of Schedule 1 of the Forestry Management Agreement are only payable as a percentage of the proceeds from harvest and sale of the 'Trees', or from insurance proceeds. Interest payable under the Loan Agreements is incurred and payable quarterly in arrears. Accordingly, the prepayment provisions in sections 82KZME to 82KZMF have no application to this Arrangement.

99. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project chose to prepay interest under a Loan Agreement with Willmott Finance or chose or are required to prepay interest under a loan agreement with a lender other than Willmott Finance. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

100. Growers who choose to prepay interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

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

Section 35-55 – Commissioner's discretion

101. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years discussed in paragraph 68, the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14; *Income tax: Division 35 - non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years discussed in paragraph 66:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests 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.

102. 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

103. 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.

Part IVA – general tax avoidance provisions

104. 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.

105. The Willmott Forests Professional Investor – 2004 Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 65 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

106. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale 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 is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

107. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2002, Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 less \$400, or \$4,000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 less \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2003, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TR 98/22;
TR 2000/8; TR 2001/14; TD 93/34

Subject references:

- advance deductions and expenses for certain forestry expenditure
- carrying on a business
- commencement of business
- fee expenses
- forestry agreement
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- seasonally dependent agronomic activity
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)

- ITAA 1936 82KZMG
- ITAA 1936 82KZMG(1)
- ITAA 1936 82KZMG(2)
- ITAA 1936 82KZMG(3)
- ITAA 1936 82KZMG(4)
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- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
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- ITAA 1936 318
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- ITAA 1997 8-1
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- ITAA 1997 Div 35
- ITAA 1997 35-10
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