



PR 2006/108 - Income tax: Australian Growth Timber Project No. 6 (2006 Growers)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *7 June 2006*



Product Ruling

Income tax: Australian Growth Timber Project No. 6 (2006 Growers)

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

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

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

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

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. 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 and how the product fits an existing portfolio. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme is not carried out as described, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the scheme will be carried out as described in this Product Ruling.

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling, this scheme is referred to as the 'Australian Growth Timber Project No. 6 (2006 Growers)' or simply as the 'Project'.

Relevant provision(s)

2. The relevant provisions 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 17-5 of the ITAA 1997;
 - section 25-25 of the ITAA 1997;
 - Division 27 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - Subdivision 61-J of the ITAA 1997;
 - Division 328 of the ITAA 1997;
 - Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZL of the ITAA 1936;
 - sections 82KZME to 82KZMG of the ITAA 1936; and
 - Part IVA of the ITAA 1936.

Note: All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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. Entities 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 participants are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies is the entities who enter into the scheme, specified below, on or after the date this Ruling is made. They will have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, these entities are referred to as 'Growers'.

8. The class of entities to whom this Ruling applies does not include entities who:

- intend to terminate their involvement in the scheme prior to its completion or who otherwise do not intend to derive assessable income from it;
- participate in the Project through offers made other than through the Product Disclosure Statement;
- have entered into the scheme specified below prior to the date this Ruling is made or after 30 June 2006;
- elect to sell the Wood Harvested from their Woodlot in accordance with clause 10 of the Management Agreement ('Electing Growers');
- have their application conditionally accepted by Primary Securities Ltd subject to finance for the payment of the Application Money, where the finance has not been approved by the lender or the funds have not been made available to Primary Securities Ltd by 30 June 2006; and
- finance their participation in the Project with loans other than from Australian Growth Finance Limited as described in paragraphs 56 and 57 of this Ruling.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 60 of this Ruling.

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

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

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Date of effect

12. This Ruling applies prospectively from 7 June 2006, 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

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

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

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

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

Withdrawal

16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provision(s) ruled upon, to all entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entity's involvement in the scheme.

Scheme

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

- Application for Product Ruling as constituted by documents provided on 10 April 2006, and additional correspondence received 2 May 2006, 9 May 2006, 10 May 2006, 12 May 2006, 19 May 2006, 24 May 2006 and 30 May 2006;
- Draft Product Disclosure Statement for the Australian Growth Timber Project No. 6, received 24 May 2006;
- Draft **Constitution** of the Australian Growth Timber Project No. 6 between Primary Securities Ltd and the Grower received 10 April 2006 and amended 9 May 2006;
- Draft Custodian Agreement between Primary Securities Ltd (as 'Responsible Entity') and Robert Garton Smith (as 'Custodian'), received 10 April 2006 (Custodian Agreement);
- Draft Compliance Plan for the Australian Growth Timber Project No. 6 received 10 April 2006;
- Draft **Management Agreement** for the Australian Growth Timber Project No. 6 between Primary Securities Ltd (as 'Responsible Entity') and the Grower, received 24 May 2006;

- Draft Plantation Management Agreement for the Australian Growth Timber Project No. 6 between Primary Securities Ltd (as Responsible Entity), RuralAus Plantation Management Pty Ltd (the 'Plantation Manager') and RuralAus Investments Limited, received 10 April 2006;
- Draft Responsible Entity Services Agreement between Australian Growth Limited (the 'Holding Company'), RuralAus Plantation Management Pty Ltd (the 'Plantation Manager'), Primary Securities Ltd and Australian Growth Managers Limited, received 10 April 2006;
- Lease to RE for the Australian Growth Timber Project No. 6 between Australian Growth Landholdings Ltd (the 'Owner') and Primary Securities Ltd (the 'lessee') and received 10 April 2006;
- Draft **Woodlot Sub-Lease** for the for the Australian Growth Timber Project No. 6 between Primary Securities Ltd (the 'Responsible Entity') and the Grower received 10 April 2006;
- Draft **Rules** for the for the Australian Growth Timber Project No. 6 by Primary Securities Ltd (the 'Responsible Entity') received 10 April 2006;
- Draft **Terms Agreement** for the Australian Growth Timber Project No. 6 between the Terms Grower (as the Terms Grower named in item 1 of the Schedule) and Primary Securities Ltd (the 'Responsible Entity') received 9 May 2006; and
- Draft Finance Application for the Australian Growth Timber Project No. 6, received 24 May 2006.

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

18. 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.

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

Overview

20. The salient features of the Australian Growth Timber Project No. 6 (2006 Growers) are as follows:

Location	The South West of Western Australia near Bremer Bay
Type of business to be carried on by each participant	Commercial growing and cultivation of Tasmanian blue gum, <i>Eucalyptus globulus</i> , trees for the purpose of harvesting and selling wood for woodchips
Number of hectares offered for cultivation	450
Minimum Allotment	1 Woodlot
Size of each Woodlot	1 Hectare
Minimum subscription	50 Woodlots
Number of trees per hectare	900 trees at planting
Term of the Project	Approximately 10-13 years
Initial cost per Woodlot	\$6,600
Ongoing costs	Deferred Management Fee of 6.6% of the Gross Proceeds of Sale per Woodlot; and Rent of 4.4% of the Gross Proceeds of Sale.
Other costs	Wood Production Costs

21. The Project will be a registered Managed Investment Scheme under the *Corporations Act 2001*. Primary Securities Ltd is the Responsible Entity for this Project and has an Australian Financial Services Licence. The land for the Project is part of two properties called 'Top Block' and 'Old Myamba' at Bremer Bay in the South West of Western Australia.

22. An offer to participate in the Project will be made through a Product Disclosure Statement ('PDS'). The offer under the PDS is for 450 hectares and participants will be invited to apply for one or more one hectare 'Woodlot'. The minimum subscription for the Project is 50 Woodlots.

23. Each Grower will enter into a Woodlot Sub-Lease and a Management Agreement with the Responsible Entity. Under the Woodlot Sub-Lease, the Grower will lease an identifiable area of land called a Woodlot. This will enable the Grower to carry on the business of afforestation for the commercial production of Tasmanian blue gum (*Eucalyptus globulus*) trees. An average of no less than 900 trees will be planted per Woodlot.

24. Under the Management Agreement, Growers will engage the Responsible Entity to plant, manage, maintain and Harvest the Trees on their Woodlots. Growers may elect to market and sell their own Wood by notice in writing to the Responsible Entity by 30 June 2007.

This Ruling does not apply to Growers who make such an election. The Responsible Entity will sell the Wood Harvested on behalf of Growers who do not elect to market and sell their own Wood.

25. Upon Application, Growers will execute a Power of Attorney enabling Primary Securities Ltd to act on their behalf as required. This will enable Primary Securities Ltd to enter into the Project Agreements on behalf of the Grower.

Constitution

26. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Primary Securities Ltd agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 6 of the Constitution, the Responsible Entity must keep a register of Growers.

27. Once a Woodlot has been allotted the Responsible Entity will enter into the Woodlot Sub-Lease and the Management Agreement with the Grower (clause 3.3).

28. Under the terms of the Constitution each Grower agrees that the Responsible Entity shall have irrevocable power as the agent of the Grower. All moneys received from Applications shall be paid to the Responsible Entity, in its capacity as a bare trustee, and held in the Trust Account (clause 6).

29. Among other things the Constitution sets out in detail the following:

- general functions, powers and duties (clauses 6 to 9);
- deal with Receipts and other money in the Trust Account of the Grower (clause 11);
- complaints (clause 12);
- withdrawal from the Project, and buy-back or re-purchase of any Tree Right (clause 13);
- termination (clause 14);
- payments to Growers (clause 19); and
- compliance with the Rules laid down by the Responsible Entity (clause 22).

Custodian Agreement

30. The Custodian is to hold the 'Application Fee' and 'Project Property' as agent for the Responsible Entity in its capacity as a bare trustee for Applicants or Growers. Further, it will observe all of the usual duties and obligations of an agent acting in the best interest of its principal and in a professional and business like manner (clause 6).

Compliance Plan

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

Interest in land

32. Primary Securities Ltd procures the Project land from the Owner under the 'Lease to RE'. Growers participating in the scheme will then enter into a Woodlot Sub-Lease with Primary Securities Ltd in its capacity as Responsible Entity. Growers are granted a lease over an identifiable area of land called a Woodlot for the purpose of carrying out Tree Farming and the Harvesting of the Trees. The Woodlot Sub-Lease will commence from the date Woodlots are allotted to Growers and will continue until 30 June 2019 or completion of Harvest, whichever is earlier.

33. The Woodlot Sub-Lease sets out the roles and obligations of Primary Securities Ltd (as Lessor) and the Grower (as Lessee). The Lease to RE and Woodlot Sub-Lease entitle the Grower to the Trees planted on the Woodlots and to the Wood from those Trees.

34. Under the Woodlot Sub-Lease, the Grower is granted the non-exclusive right to use:

- (a) any of the Lessor's rights to draw water from the Land or any dam or water source to which the Lessor has access; and
- (b) all infrastructure, plant and equipment available to, or owned by the Owner in relation to the rights referred to in (a) above.

35. Each Grower must pay Rent to the Lessor being an amount set out in clause 4 of the Woodlot Sub-Lease.

Management Agreement

36. Each Grower enters into a Management Agreement with the Responsible Entity on the date their Application is accepted and a Woodlot(s) is allotted.

37. The Management Agreement provides that each Grower engages the Responsible Entity as an independent contractor to perform the services detailed in the Plantation Management Plan. These services include planting, maintaining and managing the Grower's Woodlot and Harvesting and selling the Wood. The Responsible Entity may employ agents or contactors to operate the Project. The Responsible Entity, by execution of the Plantation Management Agreement, contracts RuralAus Plantation Management Pty Ltd to manage the Woodlots on its behalf.

38. Clause 5 of the Management Agreement specifies the Tree Farming services to be performed by the Responsible Entity. The Plantation Establishment Services and Planting Services include the following:

- prepare and grade Woodlots for the planting of Trees in a proper and skilful manner pursuant to the Plantation Management Plan;
- embark on operations to prevent or combat land degradation;
- select and purchase plant-stock which, to the best of the knowledge and belief of the Responsible Entity or its contractors or consultants, are high yielding and being of the specie or species as set out in the Plantation Management Plan;
- plant on each Woodlot an average of 900 Trees per Woodlot; and
- if at 13 months from the completion of planting, the average number of Trees per Woodlot is less than an average of 850 Trees per Woodlot, the Responsible Entity will plant additional Trees so that there is an average of 850 Trees per Woodlot on the Plantation.

39. Plantation Establishment Services will be completed within 12 months of Allotment of Woodlots to Growers. Planting Services will be completed by 30 September 2007.

40. Ongoing services to be performed under the Management Agreement include:

- tend to the Trees according to the principles of good forestry, including watering, pruning, fertilising and fumigating as the Responsible Entity deems appropriate to promote Tree growth and yields;
- establish, maintain and keep the roads, fences and gates and all other improvements on the Land in good and substantial repair and condition and if and when necessary, to replace and repair those improvements;
- do such things as may reasonably be required to eradicate, exterminate and keep the Woodlots and the Land free from disease, rodents, vermin, noxious weeds, rabbits, kangaroos, insects and all other pests of any kind, that may impact on the growth and performance of the Trees; and

- keep the Woodlots and immediate surroundings in a thorough state of cleanliness.

Planting

41. Under the Management Agreement the Responsible Entity is required to prepare the land for planting and to select and purchase plant-stock of Tasmanian blue gum (*Eucalyptus globulus*). Plantation Establishment Services will be completed within 12 months of Allotment of the Woodlots to the Grower. The Responsible Entity will complete the Planting services by 30 September 2007. Sufficient Trees will be planted so that there is an average of no less than 900 Trees per Woodlot. The Responsible Entity will conduct a survival count 13 months after the Trees have been planted and if necessary plant additional Trees so that the average number of Trees per Woodlot is an average of no less than 850 Trees.

Harvesting and sale

42. The Responsible Entity will harvest each Tree on the Woodlots on one occasion during the Term. The Harvest will take place as and when deemed appropriate by the Responsible Entity in keeping with sound forestry practice.

43. A Grower may elect to sell the Wood Harvested from their Woodlot by notice in writing to the Responsible Entity by 30 June 2007. This Product Ruling does not apply to electing Growers.

44. All other Growers irrevocably appoint the Responsible Entity to sell the Wood Harvested from their Woodlots (Non-Electing Growers). The Responsible Entity will pool all Wood from Non-Electing Growers for the highest practicable price (clause 10, Management Agreement).

45. In any agreement for sale of the Wood, the Responsible Entity shall ensure that the agreement provides that the purchase price is to be paid without deduction to the Responsible Entity.

46. The Responsible Entity will place the proceeds from the sale of the Wood into the Trust Account. Within 2 months of receipt of the proceeds the Responsible Entity must distribute to each Non-Electing Grower their proportional interest in the Net Proceeds of Sale. The Net Sales Proceeds are the proceeds from the sale of the Wood less the Wood Production Costs, Rent and Management Fees. Wood Production Costs include Harvest costs, marketing costs, and the Delivery of the Wood and any other associated costs necessary to prepare the Growers' Wood for sale and if applicable includes the cost of chipping the Wood.

Plantation Management Agreement

47. The Plantation Management Agreement is between Primary Securities Ltd as the Responsible Entity, RuralAus Plantation Management Pty Ltd as the Plantation Manager and RuralAus Investments Limited. This Agreement appoints RuralAus Plantation Management Pty Ltd to carry out and perform the obligations of the Responsible Entity under the Management Agreement.

Fees

48. The fees payable under the Woodlot Sub-Lease and the Management Agreement on a per Woodlot basis are as follows:

- Management Fees of \$6,600 for Plantation Establishment Services (\$6,380) and Planting Services (\$220). Under the PDS, a Grower can choose to pay the Management Fees at the time of Application or over a 12 month period if the Grower chooses the Terms Payment Option offered by the Responsible Entity (refer to paragraphs 51 to 55 of this Ruling);
- a Management Fee of 6.6% of the Gross Proceeds of Sale per Woodlot. The Management Fee is payable in consideration for the Responsible Entity performing the Tree Farming services for the period from the completion of Planting Services to the completion of Harvest and is deducted from the Gross Proceeds of Sale;
- Rent of 4.4% of the Gross Proceeds of Sale. This fee is for the lease of an area of land from the date a Woodlot is allotted to the Grower until 30 June 2019 or completion of the Harvest, whichever is the earlier and is deducted from the Gross Proceeds of Sale; and
- Wood Production Costs, as described in paragraph 46 of this Ruling, to be deducted from the Gross Proceeds of Sale.

Finance

49. Growers may fund their participation in the Project themselves, through a Terms Payment Option with the Responsible Entity, through finance provided by Australian Growth Finance Limited, or borrow from an independent lender.

50. This Ruling will only apply to Growers who enter into financial arrangements with Primary Securities Ltd or Australian Growth Finance Limited that do not differ from the arrangements described in paragraphs 51 to 57 of this Ruling.

Terms Payment Option

51. The Terms Payment Option is only available to Growers applying for 5 or more Woodlots. If a Grower chooses to pay the Application Money under the Terms Payment Option they must complete a Terms Application and a Direct Debit Request. The Responsible Entity will execute a Terms Agreement on the Grower's behalf.

52. Where the Responsible Entity accepts a Grower's Application to pay the Application Money under the Terms Payment Option an amount of \$7,128 is payable. This comprises a deposit of \$1,128, payable on Application, with the balance payable by 12 monthly instalments of \$500.

53. The first monthly instalment is payable on the last business day of July 2006. If a Grower does not pay the required instalments under the Terms Agreement, then the balance of Application Moneys, Interest and any other additional costs payable under the Terms Agreement will become immediately due and payable. In addition, the Responsible Entity may take legal proceedings to recover the amount, take possession of the Woodlot and do anything an owner of secured property is entitled to do (clause 11.2 of the Terms Agreement).

54. The deposit on Application is applied first to \$580 for GST in relation to the Management Fees for Planting Establishment Services, second to \$20 for GST in relation to Planting Services, third to \$48 for GST in relation to the Management fee for processing, fourth to \$200 to the Management Fee for Planting Services, and then fifth to \$280 to the Management Fee for Plantation Establishment Services.

55. The total amount payable under the Terms Payment Option includes a fee of \$528 per Woodlot for processing the Terms Payment Option.

Finance from Australian Growth Finance Limited

56. Finance will be provided by Australian Growth Finance Ltd on a full recourse commercial basis under the following finance arrangement:

- payment of the Application Money of \$6,600, including GST, by 60 equal instalments payable monthly in advance;
- an Application Fee of \$50; and
- interest at a Concessional Rate of 10.95% per annum, provided interest is paid on or before the due date and there is no default by the Grower. If interest is not paid on or before the due date or there is a default by the Grower interest will be charged at 14.95% per annum.

57. Security will be a fixed charge over the borrower's interest in the Project. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

58. Other than where the 'Application Money' is paid under the Terms Payment Option, Growers cannot rely on any part of this Ruling if the 'Application Money', is not paid in full on or before 30 June 2006 by the Grower or, on the Grower's behalf, by a lending institution. If the Application is subject to finance the Finance Application Form will not be accepted and Allotment will not occur until the finance has been approved by Australian Growth Finance Limited and written evidence of that approval has been given to the Custodian by 30 June 2006.

59. This Ruling will not apply to Growers who enter into finance arrangements with Primary Securities Ltd or Australian Growth Finance Limited, with terms and conditions that differ in any way from those set out in paragraphs 49 to 57 of this Ruling.

60. This Ruling does not apply if a Grower enters into a finance agreement that 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' will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936, or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate;
- 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 are involved in the provision of finance for the Project other than Australian Growth Finance Limited or Primary Securities Ltd under the Terms Payment Option or the finance arrangement described at paragraphs 56 and 57 of this Ruling.

Ruling

Application of this Ruling

61. Subject to paragraph 8, this Ruling will only apply to a Grower who is accepted to participate in the Project on or before 30 June 2006 and who is bound by the Management Agreement and Woodlot Sub-Lease on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

62. 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. Under the terms of the PDS and the Constitution, a Grower's Application will not be accepted and the Project will not proceed until the minimum subscription of 50 Woodlots is achieved.

The Simplified Tax System (STS)

Division 328

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

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

25% entrepreneurs tax offset

Subdivision 61-J

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

Assessable income**Section 6-5**

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

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

Deductions for Management Fees, Interest and Borrowing Costs**Section 8-1 and section 25-25**

68. A Grower who is accepted to participate in the Project on or before 30 June 2006 may claim tax deductions, on a per Woodlot basis, under section 8-1 and section 25-25, for the revenue expenses set out in the Table below.

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Management Fee for Plantation Establishment Services	\$6,380 See Notes (i) & (ii)		
Management Fee for Planting Services	To be calculated See Notes (i) & (iii)		
Interest	As incurred See Note (iv)	As incurred See Note (iv)	As incurred See Note (iv)
Borrowing Costs	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated See Note (v)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Under section 82KZMG of the ITAA 1936 the Management Fee for Plantation Establishment Services is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 94 to 99 of this Ruling) and is deductible in the income year in which it is incurred.

- (iii) On Application, the Grower prepays an amount of \$220 per Woodlot for Planting Services. If a Grower prepays fees for the doing of a thing that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purposes of this Project, 'excluded expenditure' refers to an amount of expenditure of less than \$1,000. A Grower who acquires 4 or less Woodlots incurs expenditure of less than \$1,000 and therefore, the amount is deductible in full in the year in which it is incurred. However, where a Grower acquires 5 or more Woodlots the Grower **MUST** determine the deduction using the formula shown in paragraph 98 of this Ruling.
- (iv) Interest paid under a loan agreement with Australian Growth Finance Ltd (as described at paragraphs 56 and 57 of this Ruling) is deductible in the year in which it is incurred. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Australian Growth Finance Ltd is outside the scope of this Ruling. Growers who borrow from lenders other than Australian Growth Finance Ltd may request a private ruling on the deductibility of the interest incurred. All Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 92 to 93 of this Ruling as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply where the prepayment is required under the relevant loan agreement or is at the Grower's choice.
- (v) The Application Fee of \$50 payable to Australian Growth Finance Limited is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Australian Growth Finance Limited is outside the scope of this Ruling.

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

Section 35-55 – Commissioner’s discretion

69. A Grower who is an individual accepted into the Project on or before 30 June 2006 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 2006 to 30 June 2019**. 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.

Section 82KL and Part IVA

70. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Woodlot Sub-Lease 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 and 82KZMF (but see paragraph 92 of this Ruling);
- 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.

Commissioner of Taxation

7 June 2006

Appendix 1 – Explanation

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

Is the Grower carrying on a business?

71. For the amounts set out in the Table above to constitute allowable deductions the Grower's afforestation activities as a participant in the Australian Growth Timber Project No. 6 (2006 Growers) must amount to the carrying on of a business of primary production.

72. Where there is a business, or a future business, the gross proceeds from the sale of the Wood 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.

73. For schemes such as that of the Australian Growth Timber Project No. 6 (2006 Growers), Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

74. 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 by licence) in the land on which the Grower's trees are established;
- the Grower has a right to Harvest and sell the Wood from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

75. In this Project, each Grower enters into a Management Agreement and a Woodlot Sub-Lease.

76. Under the Woodlot Sub-Lease each individual Grower will have rights over a specific and identifiable area of land. The Woodlot Sub-Lease provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the Woodlot Sub-Lease the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The Woodlot Sub-Lease allows the Responsible Entity to come onto the land to carry out its obligations under the Management Agreement.

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

78. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the Wood grown on the Grower's Woodlot.

79. 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.

80. 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 Wood that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

81. The pooling of Wood from trees grown on the Grower's Woodlot with the Wood of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled Wood will reflect the proportion of the trees contributed from their Woodlot.

82. The Responsible Entity'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. While the size of a Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable.

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

84. 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 Growers' afforestation activities in the Australian Growth Timber Project No. 6 (2006 Growers) will constitute the carrying on of a business.

The Simplified Tax System

Division 328

85. 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.

86. Changes to the STS rules apply from 1 July 2005. 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 Management Fees

Section 8-1

87. Consideration of whether the Management Fees for Plantation Management Services and Planting Services 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.

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

Interest deductibility

Section 8-1

(i) Growers who use Australian Growth Finance Limited as the finance provider

89. A Grower may finance their participation in the Project through a loan facility with Australian Growth Finance Limited. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the Management Fees.

90. The interest incurred for the year ended 30 June 2006 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of Tasmanian blue gum trees and the lease of the land on which the trees have been planted – 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.

(ii) Growers who DO NOT use Australian Growth Finance Limited as the finance provider

91. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Australian Growth Finance Limited 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***

92. 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 forestry 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.

93. For this Project, only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936 are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

94. Other than expenditure deductible under section 82KZMG of the ITAA 1936, if the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

95. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the scheme has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the scheme are managed by someone other than the taxpayer; and

- either:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the entity who promotes, arranges or manages the agreement (or an associate of that entity) promotes similar agreements for other taxpayers.

96. For the purpose of these provisions, the scheme includes all activities that relate to the scheme (subsection 82KZME(4) of the ITAA 1936). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than Australian Growth Finance Limited. Although undertaken with an unrelated party, that financing would be an element of the scheme. The funds borrowed and the resulting interest deductions are directly related to the activities under the scheme. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

97. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the scheme that is less than \$1,000. Such expenditure is immediately deductible.

98. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

99. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Section 82KZMG

100. Under subsection 82KZMG(1) of the ITAA 1936, 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).

101. Subsection 82KZMG(2) of the ITAA 1936 requires that the expenditure is:

- incurred on or after 2 October 2001 and on or before 30 June 2008;
- 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.

102. To satisfy subsection 82KZMG(3) of the ITAA 1936 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:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer;
 - b) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

103. Under subsection 82KZMG(4) of the ITAA 1936 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. The term 'seasonally dependent agronomic activities' is explained in Taxation Determination TD 2003/12.

104. Subsection 82KZMG(5) of the ITAA 1936 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

105. Under the Management Agreement, a Grower incurs a Management Fee for Plantation Establishment Services of \$6,380 per Woodlot for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG of the ITAA 1936 have been met, a deduction is allowable in the income year ended 30 June 2006 for the expenditure incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

106. The Management Agreement also requires the Grower to prepay a Management Fee of \$220 per Woodlot for Planting Services. As the prepaid Management Fee is less than \$1,000 per Woodlot it constitutes 'excluded expenditure' as defined in subsection 82KZL(1) of the ITAA 1936. 'Excluded expenditure' is an exception to the prepayment rules and is deductible in full in the year in which it is incurred. Therefore, a Grower who acquires 4 or less Woodlots can claim a deduction for the prepaid Management Fee for Planting Services in the income year in which it is incurred.

107. However, where a Grower acquires 5 or more Woodlots and the amount of the prepaid Management Fees is more than \$1,000, the deduction allowable for those amounts will be subject to apportionment according to the formula shown in paragraph 98 of this Ruling.

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

Section 35-55 – exercise of Commissioner's discretion

108. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2006 to 30 June 2019** 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 ended 30 June 2006 up to and including 30 June 2019:

- 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.

109. 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

110. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1997.

Part IVA – general tax avoidance provisions

111. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

112. The Australian Growth Timber Project No. 6 (2006 Growers) 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 paragraph 68 of this Ruling 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.

113. 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 wood produce. 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) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2003/12; TR 97/11;
TR 98/22; TR 2000/8;
TR 2001/14

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
- non-commercial losses
- producing assessable income
- product rulings
- public rulings
- seasonally dependent agronomic activity
- tax avoidance
- tax benefits under tax avoidance
- schemes
- tax shelters
- tax shelters project
- taxation administration

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NO: 2006/5952
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ timber