


PR 2007/87 - Income tax: Rewards Group Sandalwood Project 2007 (2008 Growers)

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Product Ruling

Income tax: Rewards Group Sandalwood Project 2007 (2008 Growers)

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	10
Ruling	19
Scheme	36
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	84
Appendix 2:	
Detailed contents list	128

! 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. 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 Ruling. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. Unless otherwise indicated, all legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997). In this Product Ruling the scheme is referred to as Rewards Group Sandalwood Project 2007 or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities;

- are subject to the taxation obligations; and
- can rely on the taxation benefits;

set out in the Ruling section of this Product Ruling.

3. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to as Growers.

4. Growers will be those entities that are accepted to participate in the scheme specified below as initial participants¹ on or from the date this Product Ruling is made. They will have executed the relevant Project Agreements set out in paragraph 36 of this Ruling on or before 30 June 2008.

5. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities who:

- participate in the scheme other than as initial participants;
- are accepted into this Project before the 24 October 2007, the date on which this Product Ruling is made, or after 30 June 2008;
- participate in the scheme through offers made other than through the Product Disclosure Statement (PDS); or
- enter into finance arrangements with entities associated with this Project, other than those specified in paragraph 74 of this Ruling;
- have not paid the Initial Fee by 30 June 2008, where they have not entered into a finance arrangement; or

¹ For the purposes of this Product Ruling an 'initial participant' means a participant who has obtained their interest in the scheme from the Responsible Entity or the Manager of the scheme.

- have their application conditionally accepted by a lending institution subject to finance for the payment of the Initial Fee, where the finance has not been approved by the lender by 30 June 2008 or the finance has been approved but the funds have not been made available to Rewards Projects Ltd by 31 July 2008.

Qualifications

6. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 36 to 83 of this Ruling.

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

- this Product 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 Product Ruling may be withdrawn or modified.

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Superannuation Industry (Supervision) Act 1993

9. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Date of effect

10. This Product Ruling applies prospectively from 24 October 2007, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 24 October 2007 until 30 June 2008, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2010.

11. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

12. 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)).

13. 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.

14. 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).

Changes in the law

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

16. Entities who are considering participating in the scheme 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

17. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes 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 Product Ruling is issued.

Goods and Services Tax

18. All fees and expenditure referred to in this Product 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.

Ruling

Application of this Ruling

19. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 36 to 83 of this Ruling.

20. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Management Agreement and Grower Licence Agreement.

21. 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.

Concessions for 'small business entities'²

22. From the 2007-08 income year, a range of concessions previously available under the simplified tax system (STS), will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

23. A 'small business entity' can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Because of these choices and the eligibility conditions the application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

² The meaning of 'small business entity' is explained in section 328-110.

Deductions for the Initial Fee**Section 8-1 and Division 27 of the ITAA 1997 and section 82KZMG of the Income Tax Assessment Act 1936**

24. Other than where a 'CGT event'³ happens to their interest within four years of 30 June 2008 (see paragraph 25 of this Ruling), a Grower who is an initial participant in the scheme may claim tax deductions for the following amount on a per Woodlot basis.

Fee Type	Year ending 30 June 2008	Year ending 30 June 2009	Year ending 30 June 2010
Initial Fee	\$5,000 See Notes (i) & (ii)		

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 of the ITAA 1997.
- (ii) Under section 82KZMG of the *Income Tax Assessment Act 1936* (ITAA 1936) the Initial Fee is expenditure for 'seasonally dependent agronomic activities' (see paragraphs 98 to 103 of this Ruling) and is deductible in the income year in which it is incurred.

'CGT event' within 4 years for Growers who are 'initial participants'**Section 82KZMGA**

25. A deduction for the Initial Fee is not allowable where a 'CGT event' happens in relation to a Grower's interest before 1 July 2012 (subsection 82KZMGA(1) of the ITAA 1936).

26. Where deductions for these amounts have already been claimed by a Grower the Commissioner may amend their assessment at any time within two years after the end of the income year in which the 'CGT event' happens. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 82KZMGA(2) of the ITAA 1936).

27. Growers whose deductions are disallowed are still required to include in their assessable income the market value of the interest at the time of the 'CGT event' or the decrease in the market value of the interest as a result of the 'CGT event' (see paragraphs 104 to 106 of this Ruling).

³ Defined in section 995-1.

Deductions for loan interest, borrowing costs, and application fees***Sections 8-1, 25-25 and 40-880 and Division 27***

28. A Grower who is an initial participant in the scheme may also claim tax deductions for the following fees and expenses on a per Woodlot basis, as set out in the Table below.

Fee Type	Year ending 30 June 2008	Year ending 30 June 2009	Year ending 30 June 2010
Interest on loans with Rewards Projects Ltd or the Preferred Financier		As incurred See Note (iii)	As incurred See Note (iii)
Application Fee (finance by Rewards Projects Ltd or the Preferred Financier)	See Note (iv)	See Note (iv)	See Note (iv)
Application Fee (Terms Option)	See Note (v)	See Note (v)	See Note (v)

Notes:

- (iii) Interest on loans with Rewards Projects Ltd or the Preferred Financier is deductible in the year in which it is incurred (section 8-1). The deductibility or otherwise of interest arising from agreements entered into with financiers other than Rewards Projects Ltd or the Preferred Financier is outside the scope of this Ruling. Prepayments of interest to any lender, including Rewards Projects Ltd and the Preferred Financier, are also not covered by this Product Ruling. Growers who enter into agreements with other financiers and/or prepay interest may request a private ruling on the deductibility of the interest incurred (see paragraph 97 of this Ruling).

- (iv) The Application Fee payable in respect of the finance from Rewards Projects Ltd (excluding the 12 month Terms Option) or the Preferred Financier is a borrowing expense and is deductible under section 25-25. Where the Application Fee is \$100 or less the whole of the borrowing expense is deductible in the year in which it is incurred.

Where the Application Fee is more than \$100 for loans with a term of less than 5 years the deduction for the borrowing expense is spread over the period of the loan on a straight line basis from the date the loan begins.

Where the Application Fee is more than \$100 for loans with a term of 5 years or more the deduction for the borrowing expense is spread over 5 years on a straight line basis from the date the loan begins.

The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Rewards Projects Ltd or the Preferred Financier is outside the scope of this Ruling.

- (v) The Application Fee payable to Rewards Projects Ltd in respect of the 12 month Terms Option is not deductible in full when it is incurred. Under section 40-880 it is deductible in equal proportions over five income years beginning in the year in which the administration fee is incurred (see paragraphs 119 to 120 of this Ruling).

Assessable income from 'CGT events' for Growers who are initial participants

Sections 6-10, 17-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936

29. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁴ – see paragraph 33 of this Ruling) happens to the interest held by a Grower who is an initial participant in this Project, the market value of the interest, or the decrease in the market value of the interest, is included in the Grower's assessable income (section 6-10 of the ITAA 1997 and section 82KZMGB of the ITAA 1936), less any GST payable on those proceeds (section 17-5 of the ITAA 1997).

30. The amount is included in the Grower's assessable income in the income year in which the 'CGT event' happens (subsection 82KZMGB(2) of the ITAA 1936).

⁴ A thinning of the trees includes a selective harvest of immature trees to facilitate better outcomes at harvest. A thinning differs from a clear fell of a percentage of mature trees which may occur over two or more income years.

31. 'CGT events' for these purposes include those relating to:
- a **clear-fell harvest of all or part of the trees** grown on the Grower's Woodlot(s);
 - the **sale, or any other disposal** of all or part of the 'interest' in the Project held by the Grower; or
 - any other 'CGT event' that results in a reduction of the market value of the 'interest' in the Project held by the Grower.
32. Where an amount arising from a 'CGT event' is included in the assessable income of a Grower by section 82KZMGB of the ITAA 1936 the anti-overlap provisions in section 118-20 of the ITAA 1997 will operate to exclude that amount from the capital gains provisions in Part 3-1 of the ITAA 1997.

Amounts received by Growers where the Project trees are thinned

Sections 6-5 and 17-5

33. An amount received by a Grower in respect of a thinning of the trees grown in this Project is not an amount received as a result of a 'CGT event' and is not otherwise assessable under section 82KZMGB of the ITAA 1936. The amount is a distribution of ordinary income that arises as an incident of the Grower holding an interest in the Project. Growers include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5 of the ITAA 1997) less any GST payable on those proceeds (section 17-5 of the ITAA 1997).

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

Section 35-55 – exercise of Commissioner's discretion

34. A Grower who is an individual accepted into the Project in the year ended 30 June 2008 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 Growers for the income years ended 30 June 2008 to 30 June 2027. 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.

Prepayment provisions and anti-avoidance provisions

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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME and 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.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 21, 26 and 28 July 2006, 3 and 8 August 2006, 11 September 2006 and 6, 9, 18, 20, 25, 30 and 31 October 2006; 8, 13, and 20 June 2007; 27 and 30 July 2007; 15 August 2007; 17, 18 and 20 September 2007; 8 October 2007;
- Product Disclosure Statement for the Rewards Group Sandalwood Project 2007 issued by Rewards Projects Ltd (Responsible Entity), received 20 June 2007;
- Draft Supplementary Product Disclosure Statement for the Rewards Group Sandalwood Project 2007 received 27 July 2007;
- **Constitution** for the Rewards Group Sandalwood Project 2007, received 13 June 2007;
- **Variation to Constitution** for the Rewards Group Sandalwood Project 2007 received 27 July 2007;
- Compliance Plan for the Rewards Group Sandalwood Project 2007, received 20 September 2007;
- Draft **Management Agreement** between Rewards Projects Ltd (Responsible Entity) and the Grower, received 8 October 2007;

- Draft Operations Agreement between Rewards Projects Ltd (Responsible Entity) and Rewards Management Pty Ltd (Manager), received 26 July 2006;
- **Draft Grower Licence Agreement** for 2008 Growers – First Allotment, between Rewards Projects Ltd and the Grower, received 27 July 2007;
- Draft Head Lease between Rewards Land Pty Ltd (Lessor) and the Responsible Entity (Lessee), received 27 July 2007;
- **Draft Finance Package** including Finance Agreement and Finance Application Form for the Rewards Group Sandalwood Project 2007 – 2008 Growers, received 20 September 2007;
- Plantation Management Plan for the Rewards Group Sandalwood Project 2007, received 28 July 2006;
- Independent Forester's Report, received 26 July 2006; and
- email from Independent Forester received 27 July 2007.

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

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

38. The documents highlighted are those that a Grower may enter into. For the purposes of describing the scheme 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 scheme.

39. The main features of the Project are as follows:

Location	The Western edge of the WA wheat belt within a radius of approximately 200km from Perth
Type of business to be carried on by each Grower	Commercial growing and cultivation of <i>Santalum spicatum</i> (Western Australian Sandalwood) trees for the purpose of harvesting and selling Sandalwood for timber
Term of the Project	Approximately 20 years

Number of hectares offered for cultivation	1,000
Size of each Woodlot	0.5 hectare
Minimum allocation per Grower	1 Woodlot
Minimum subscription	Nil
Initial cost	\$5,000
Ongoing costs	Insurance costs
Other costs	Maintenance and Licence Fees payable out of net harvest proceeds Harvest and sale costs deducted from harvest proceeds

40. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Rewards Projects Ltd has been issued with an Australian Financial Service Licence 224000 and will be the Responsible Entity for the Project.

41. The Project will be conducted on land located within a radius of approximately 200km from Perth, on the western edge of the WA wheat belt.

42. An offer to participate in the Project will be made through a Product Disclosure Statement and a Supplementary Product Disclosure Statement (these two documents will be collectively referred to in this Product Rulings as the PDS). The offer pertains to 2,000 Woodlots of 0.5 hectares each. There is no minimum subscription for the Project. The Responsible Entity is able to accept oversubscriptions to the extent that the Lessor reasonably expects that it will have suitable land available within nine months of acceptance. Any additional land for the Project will only be purchased if deemed suitable by the Independent Forester for the establishment of a Sandalwood plantation.

43. An entity that participates in the Project will do so by acquiring an interest in the project on or before 30 June 2008, which will consist of a minimum of one Woodlot each of 0.5 hectares in size.

44. Applicants execute a power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to execute, on behalf of the Grower, the Constitution, the Grower Licence Agreement and the Management Agreement, and any other documents required to hold an interest in the Project.

45. Growers will only be accepted into the Project by paying the Initial Fee to the Responsible Entity in full or by instalments.

46. Each Grower will use their Woodlot(s) for the purpose of carrying on a business of cultivating and harvesting Sandalwood trees and the sale of harvested produce.

47. This Ruling only applies in respect of '2008 Growers', that is, Growers who enter the Project from 24 October 2007, the date this Product Ruling is made, to 30 June 2008. Note that Product Ruling PR 2006/152 may apply to Growers who enter into the Project from 8 November 2006 to 30 June 2007.

Constitution

48. The Constitution establishes the Project, and sets out the terms and conditions under which the Responsible Entity agrees to act as Responsible Entity and manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project.

49. In order to acquire an interest in the Project, the Grower must make an application for a Woodlot/s pursuant to the PDS.

50. Under clause 8 of the Constitution, the Responsible Entity must deposit all application moneys received from Growers into a trust bank account established for this purpose. This account is referred to as the Subscription Fund. The application moneys will be released from this fund when the Responsible Entity is satisfied that certain specified criteria in the Constitution have been met (clauses 3.3 and 3.8).

51. Once the Responsible Entity has accepted an application the subscription Money will be treated by the Responsible Entity as the Grower's Project Fees (to the extent to which the Application has been accepted) and held in the Project Fund (clause 3.6).

Compliance Plan

52. As required by the *Corporations Act 2001*, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan 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.

Head Lease

53. The Responsible Entity will enter into a Head Lease with Rewards Land Pty Ltd or other parties (Lessor) in respect of Land required for the Project.

54. The Responsible Entity must use the Land only for carrying on a business of tree farming (clause 6.1).

55. Under the Head Lease, the Responsible Entity may licence the Land or any part of it to Growers in the Project for the purposes of the Project (clause 9.3).

Grower Licence Agreement

56. Growers participating in the Project will enter into a Grower Licence Agreement with the Responsible Entity. Under the Grower Licence Agreement, Growers are granted a Licence to use their Woodlot for the purpose of planting, cultivating and harvesting Sandalwood trees upon the terms and conditions set out in the Agreement (clause 2).

57. The term of the licence is from the date on which the Responsible Entity first accepts applications under the PDS until completion of the Final Harvest (approximately 20 years).

Management Agreement

58. Growers will enter into a Management Agreement with the Responsible Entity. Under the Management Agreement, each Grower engages the Responsible Entity to carry out the Initial Services and the Ongoing Services in accordance with the Management Plan and the terms of the Management Agreement (clause 2.1).

59. The Management Agreement will commence on the date on which the Responsible Entity first accepts Applications under the PDS and terminates on 30 June 2028 or such longer term as is agreed between the parties in order to allow the completion of the final Harvest, payment of proceeds and dispatch of accounts and reports in relation thereto (clause 3).

60. The Responsible Entity may sub-contract an agent or contractor to carry out some or all of these duties (clause 2.4).

61. The services to be performed by the Responsible Entity are specified in Annexure A (Initial Services) and Annexure B (Ongoing Services) of the Management Agreement.

62. The Initial Services are:

- supply sufficient Host Tree seedlings to the specifications recommended in the Management Plan;
- supply sufficient Sandalwood seed to the specifications recommended in the Management Plan; and
- ensure that the Woodlots are ready for planting in accordance with the Management Plan including ripping, mounding and herbicide spraying (if required).

63. The Ongoing Services include:

- tend to the Trees and the Host Trees according to the principles of good forestry; including such nutrient analysis, pruning, fertilising and fumigating, as the Responsible Entity deems appropriate to promote Tree growth and yields;

- maintain and repair such roads and fences as exist on the Land and otherwise keep the Woodlots in good and substantial repair and condition;
- during the first three months following the end of the Initial Period plant the Host Trees and within a further 12 months sow the Sandalwood seed;
- within 12 months of the planting of the Host Trees and the sowing of the Sandalwood seeds respectively, conduct a survival count and replant or resow the Host Trees or seeds such that there is an average 1,000 Host Trees and 1,000 Sandalwood seedlings per hectare;
- manage the Tree crop in accordance with the Management Plan; and
- determine the harvest schedule and manage each harvest in accordance with clause 6 of the Management Agreement.

64. The Responsible Entity will complete the Initial Services during the 'Initial Period' (clause 2.2). The Initial Period is a period of 12 months commencing on 1 July 2008 for Growers accepted into the Project on or before 30 June 2008.

65. The Ongoing Services will be carried out on an ongoing basis throughout the Term of the Project (clause 2.2).

Operations Agreement

66. Under the Operations Agreement, the Responsible Entity will engage the Manager, Rewards Management Pty Ltd, to carry out or cause to be carried out the Initial Services and the Ongoing Services in accordance with sound silvicultural and environmental practices adopted within the forestry industry.

Pooling of Timber and Grower's Entitlement to Net Proceeds

67. The Management Agreement and the Constitution set out provisions relating to the pooling of Growers' Timber and the distribution of proceeds from the sale of the Timber. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed Timber to the pool making up the proceeds are entitled to benefit from distributions of harvest proceeds from the pool; and
- Timber can only be pooled with the Timber of Growers who are of the same Project class.

68. The Grower's share of the pool is based on the proportion of the Woodlots they licence in relation to the total number of Woodlots held by 2008 Growers under the Project.

69. Prior to distribution to the Grower, the proceeds from the sale of Timber will be reduced by the Grower's share of harvest and sale costs and any other outstanding Project fees or other amounts payable by the Grower to the Responsible Entity under the Constitution (clause 11 of the Constitution).

70. In the event that a Grower's Woodlot(s) are destroyed or partially destroyed, the Grower's proceeds of the sale from the Timber will be reduced in accordance with the terms of clause 18 of the Constitution.

Fees

71. The fees payable under the Management Agreement and the Grower Licence Agreement, on a per Woodlot basis, are as follows:

- Initial Fee of \$5,000, payable to the Responsible Entity on the date of Acceptance of the Grower's Application, for the provision of the Initial Services during the Initial Period;
- a Maintenance Fee payable to the Responsible Entity for Ongoing Services of an amount equal to 8.36% of the Grower's Share of the sales proceeds of each harvest, after deducting all costs of and incidental to Harvest; and
- a Licence Fee payable to the Responsible Entity of an amount equal to 12.10% of the grower's share of the sales proceeds of each Harvest after deducting the Grower's share of the Harvest costs.

Insurance

72. The Responsible Entity will pay for tree insurance for the Growers' Woodlots in the first year of the Project. After this period, each Grower may elect to have the Responsible Entity arrange, on the Grower's behalf, insurance of the Grower's Trees. The election must be made annually during the term of the Project. The electing Growers are responsible for payment of the insurance premiums.

73. If a Grower has entered into a finance arrangement with Rewards Projects Ltd or the Preferred Financier, the Grower must take out insurance cover on their Woodlot(s).

Finance

74. A Grower who does not pay the Initial Fee in full upon application can:

- enter into a 12 month Terms Option (Terms Option) with the Responsible Entity;
- borrow from the Responsible Entity;
- borrow from the Preferred Financier; or
- borrow from an independent lender external to the Project.

75. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with the Responsible Entity or with the Preferred Financier that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than the Preferred Financier may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

76. Other than where the Terms Option is in place, Growers cannot rely on any part of this Ruling if the Initial Fee is not paid in full on or before 30 June 2008, by the Grower or, on the Grower's behalf, by a lending institution. However, where an application is accepted subject to finance approval by any lending institution other than the Preferred Financier, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2008 and the funds have not been made available to the Responsible Entity by 31 July 2008.

77. A Grower choosing to pay the Initial Fee of \$5,000 per Woodlot by entering into the Terms Option, a loan arrangement with the Responsible Entity or a loan arrangement with the Preferred Financier must complete the Finance Application, which includes a Direct Debit Service Agreement, and a Finance Agreement. All arrangements will be on a full recourse basis and recovery action will be taken in respect of any default.

78. Growers who enter into a Terms Option or Finance Arrangement are required to pay an Application Fee of 1% of the Finance Application Amount, subject to a minimum of \$100 and a maximum of \$500. The Application Fee is payable to the Provider on the first loan repayment date, which is 31 July 2008. Except for the Terms Option, the Interest Rate is fixed at 10.95% per annum.

79. Where a Grower enters into the Terms Option, the full amount of the Initial Fee must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

80. The amount due under each of the finance arrangements is repayable on a 'per Woodlot' basis as set out below:

12 month Terms Option

- 12 monthly payments of \$416.67

Finance from Rewards Projects Ltd

- 5 years principal and interest – 60 monthly payments of \$108.59.

Finance from the Preferred Financier

- 2 years principal and interest – 24 monthly payments of \$232.92;
- 5 years principal and interest – 60 monthly payments of \$108.59;
- 10 years principal and interest – 120 monthly payments of \$68.73; and
- 3 years interest only followed by 7 years principal and interest – 36 interest only monthly payments of \$45.63 followed by 84 monthly payments of \$85.48.

81. The instalments are paid monthly in arrears commencing on 31 July 2008.

82. The payment of the Instalment Amounts under the above arrangements is secured by a mortgage over the Grower's right, title and interest in the Project, including the Woodlots and the Grower Agreements.

83. This Ruling 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 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 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 Rewards Projects Ltd and the Preferred Financier, are involved or become involved in the provision of finance to Growers for the Project.

Commissioner of Taxation

24 October 2007

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?

84. For the amounts set out in paragraphs 24 and 28 of this Ruling to constitute allowable deductions the Grower's afforestation activities as a participant in the Project must amount to the carrying on of a business of primary production.

85. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on a business of primary production.

86. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

87. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Project. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

88. Having applied these principles to the arrangement set out above, a Grower in the Project is accepted to be carrying on a business of growing and harvesting Australian Sandalwood trees for sale.

Deductibility of the Initial Fee, and loan interest

Section 8-1

89. The Initial Management Fee is deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Initial Management Fee (see paragraphs 49 to 51 of TR 2000/8).

90. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Subject to the prepayment provisions (see paragraphs 93 to 103 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

91. Some Growers may finance their participation in the Project through a Loan Agreement with the Responsible Entity or the Preferred Financier. Applying the same principles as that used for the Initial Fee, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

92. Other than where the prepayment provisions apply (see paragraphs 93 to 103 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Prepayment provisions

Sections 82KZL to 82KZMG

93. 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 income year, then it is not expenditure to which the prepayment rules apply.

94. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and section 82KZMG of the ITAA 1936 (an operative provision). References to sections 82KZME and 82KZMF of the ITAA 1936 are made only in respect of their interaction with sections 82KZMG of the ITAA 1936 and to confirm that these provisions have no application to expenditure incurred by Growers who participate in the scheme set out in this Ruling.

Application of the prepayment provisions to this Project

Sections 82KZME and 82KZMF

95. Other than the Initial Fee (see below), the fees payable under the scheme to which this Product Ruling applies are payable only out of harvest proceeds, and the interest payable to the Responsible Entity or to the Preferred Financier, is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application.

96. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project chooses or is required to prepay interest under a loan agreement (including loan agreements with lenders other than the Responsible Entity or the Preferred Financier).

97. As stated in Note (iii) of paragraph 28 of this Ruling, prepayments of interest are not covered by this Product Ruling and Growers who make such prepayments may instead request a private ruling on the tax consequences of the prepaid interest.

Section 82KZMG

98. Expenditure that meets the requirements of section 82KZMG of the ITAA 1936 is excluded from the application of the prepayment rules in sections 82KZME and 82KZMF of the ITAA 1936 that would otherwise apply.

99. Section 82KZMG of the ITAA 1936 provides a '12 month rule' that, in effect, facilitates an immediate deduction for certain prepaid expenditure⁵ incurred under an 'agreement for planting and tending trees for felling' (subsection 82KZMG(3) of the ITAA 1936).

100. The 12 month rule applies to expenditure for 'seasonally dependent agronomic activities' that will be carried out during the establishment period of a particular planting of trees (subsection 82KZMG(4) of the ITAA 1936). Seasonally dependent agronomic activities are explained in Taxation Determination TD 2003/12.

101. Whilst the establishment period itself may exceed 12 months, each seasonally dependent agronomic activity must be completed within 12 months of commencement of its eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936), and by the end of the income year following the 'expenditure year' (see subsections 82KZMG(1) and (2) of the ITAA 1936).

102. Under the Management Agreement each Grower incurs an Initial Fee of \$5,000 per Woodlot in the income year ended 30 June 2008 for 'seasonally dependent agronomic activities' that will be carried out during the 'establishment period' of the Trees.

103. The expenditure for 'seasonally dependent agronomic activities' meets all other requirements of section 82KZMG of the ITAA 1936 and, therefore, other than where section 82KZMGA of the ITAA 1936 applies (see paragraphs 104 to 106 of this Ruling), a deduction is allowable in the income year ended 30 June 2008 for the full amount of expenditure incurred by the Grower for the Initial Fee.

'CGT event' within 4 years for Growers who are initial participants

Section 82KZMGA

104. A Grower who is an initial participant in the Project cannot deduct an amount that meets the requirements of section 82KZMG of the ITAA 1936 if a 'CGT event' happens in relation to the Grower's interest within 4 years of 30 June 2008 (subsection 82KZMGA(1) of the ITAA 1936). In this Project, only the Initial Fee meets the requirements of section 82KZMG of the ITAA 1936. Accordingly, the deduction of \$5,000 per 'interest' for the Initial Fee will not be allowable if a 'CGT event' happens to the Grower's interest within the 4 year period.

⁵ The expenditure must be incurred on or before 30 June 2008 (subsection 82KZMG(2) of the ITAA 1936).

105. Where subsection 82KZMGA(1) of the ITAA 1936 applies, the Commissioner may amend any affected Grower's assessment within 2 years after the end of the income year in which the 'CGT event' happens. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 82KZMGA(2) of the ITAA 1936)

106. A Grower whose deduction for the Initial Fee is disallowed because of section 82KZMGA of the ITAA 1936 is still required to include in their assessable income the market value of the interest at the time of the 'CGT event' or the decrease in the market value of the interest as a result of the 'CGT event' (section 82KZMGB of the ITAA 1936).

Assessable income from 'CGT events' for Growers who are initial participants

Sections 6-10, 10-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936

107. Section 6-10 of the ITAA 1997 includes in assessable income amounts that do not constitute ordinary income. These amounts, called statutory income, are listed in the table in section 10-5 of the ITAA 1997 and include amounts that are included in the assessable income of a Grower by section 82KZMGB of the ITAA 1936.

Section 82KZMGB

108. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)⁶ happens to an interest held by a Grower who is an initial participant in this Project, section 82KZMGB includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted the Initial Fee (shown in paragraph 24 of this Ruling); and
- subsection 82KZMG(1) of the ITAA 1936 applies to the timing of the deduction of the Initial Fee (or would apply if section 82KZMGA of the ITAA 1936 were disregarded – see above).

Market value rule applies to 'CGT events'

109. If, as a result of the 'CGT event' the Grower either:

- no longer holds the interest; or

⁶ A thinning under this scheme is not a 'CGT event'.

- otherwise – where the Grower continues to hold the 'forestry interest' but there is a decrease in the market value of the interest,

then the market value of the interest at the time of the event, or the decrease in market value of the interest as a result of the event, is included in the assessable income of the Grower (subsection 82KZMGB(2) of the ITAA 1936). A market value rule applies rather than the amount of money actually received from the CGT event (subsection 82KZMGB(3) of the ITAA 1936). However, the market value and the actual amount of money received may be the same.

110. The market value amount included in the assessable income of a Grower is the value of the interest just before the 'CGT event', or where the Grower continues to hold their interest after the 'CGT event', the amount by which the market value of the interest is reduced by the 'CGT event' (subsection 82KZMGB(2) of the ITAA 1936).

111. This provision will apply where the interest is sold, is extinguished, or ceases, and will include 'CGT events' such as a full or partial sale of the interest or from a full or partial clear-fell harvest of the trees grown under the Project.

Anti-overlap provisions

Section 118-20

112. Generally, where as a result of a 'CGT event' a capital gain would otherwise be included in a taxpayer's assessable income section 118-20 will apply to reduce the capital gain if, because of the event, a provision of the ITAA 1997 other than the CGT provisions includes an amount in the taxpayer's assessable income.

113. In the case of interests held by Growers who are initial participants in this Project, the market value, or the reduction in the market value of the interest from a CGT event is included in assessable income by section 6-10 of the ITAA 1997 and section 82KZMGB of the ITAA 1936. Therefore, section 118-20 of the ITAA 1997 will operate to reduce to nil any capital gain that would otherwise be assessable under the CGT provisions in Part 3-1 of the ITAA 1997.

Amounts received by initial participants where the Project trees are thinned

Section 6-5

114. Section 82KZMGB of the ITAA 1936 specifically excludes from its operation a 'CGT event' that happens in respect of a thinning (see paragraph 82KZMGB(1)(d) of the ITAA 1936).

115. Thinning amounts received by a Grower who is an initial participant in this Project do not arise as a result of a 'CGT event' and are not otherwise assessable under section 82KZMGB of the ITAA 1936. The receipt of an amount arising from a thinning of the Project trees is a distribution that arises as an incident of the Grower holding an interest in the Project. It is an item of ordinary income and is assessable under section 6-5 of the ITAA 1997 in the year in which it is derived.

Borrowing costs

Section 25-25

116. A deduction is allowable for expenditure incurred by a Grower in borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income (subsection 25-25(1)).

117. In this Project, the Loan Application Fee payable to either the Responsible Entity or the Preferred Financier is incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

118. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the borrowing expenses exceed \$100, the deduction for the borrowing expense is spread over the period of the loan or 5 years, whichever is the shorter (subsection 25-25(4)).

Application Fee payable under a Terms Payment Agreement

Section 40-880

119. Growers who elect to pay their Initial Fee under the Terms Option must pay an application fee. This expenditure does not constitute a borrowing expense and is therefore not deductible under section 25-25. As it is capital in nature it is also not deductible under section 8-1.

120. However, section 40-880 will allow the application fee to be deducted in equal proportions over five income years starting in the year in which the Grower incurred the amount (subsection 40-880(2)). Section 40-880 applies to capital expenditure that is incurred in relation to a business and which is not taken into account elsewhere or denied deductibility under another provision of income tax law (subsection 40-880(1)).

Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion

121. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending 30 June 2008 to 30 June 2027, the Commissioner has applied the principles set out in Taxation Ruling TR 2007/6 Income tax: non commercial business losses: Commissioner's discretion. Based on the evidence supplied, the Commissioner has determined that for those income years:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the Australian Sandalwood growing industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

122. 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.

123. 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

124. 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

125. 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).

126. The 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 24 and 28 of this Ruling that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

127. 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) 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

128. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Class of entities	2
Qualifications	6
Superannuation Industry (Supervision) Act 1993	9
Date of effect	10
Changes in the law	15
Note to promoters and advisers	17
Goods and Services Tax	18
Ruling	19
Application of this Ruling	19
Concessions for 'small business entities'	22
Deductions for the Initial Fee	24
<i>Sections 8-1 and Division 27 of the ITAA 1997 and section 82KZMG of the Income Tax Assessment Act 1936</i>	24
'CGT event' within 4 years for Growers who are 'initial participants'	25
<i>Section 82KZMGA</i>	25
Deductions for loan interest, borrowing costs and application fees	28
<i>Sections 8-1, 25-25 and 40-880 and Division 27</i>	28
Assessable income from 'CGT events' for Growers who are initial participants	29
<i>Sections 6-10, 17-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936</i>	29
Amounts received by Growers where the Project trees are thinned	33
<i>Sections 6-5 and 17-5</i>	33
Division 35 – deferral of losses from non-commercial business activities	34
<i>Section 35-55 – exercise of Commissioner's discretion</i>	34
Prepayment provisions and anti-avoidance provisions	35
<i>Sections 82KZME, 82KZMF, 82KL and Part IVA</i>	35
Scheme	36

Constitution	48
Compliance Plan	52
Head Lease	53
Grower Licence Agreement	56
Management Agreement	58
Operations Agreement	66
Pooling of Timber and Grower's Entitlement to Net Proceeds	67
Fees	71
Insurance	72
Finance	74
Appendix 1 – Explanation	84
Is the Grower carrying on a business	84
Deductibility of the Initial Fee and loan interest	89
<i>Section 8-1</i>	89
Prepayment provisions	93
<i>Sections 82KZL to 82KZMG</i>	93
Application of the prepayment provisions to this Project	95
<i>Sections 82KZME and 82KZMF</i>	95
<i>Section 82KZMG</i>	98
'CGT event' within 4 years for Growers who are initial participants	104
<i>Section 82KZMGA</i>	104
Assessable income from 'CGT events' for Growers who are initial participants	107
<i>Sections 6-10, 10-5 and 118-20 of the ITAA 1997 and section 82KZMGB of the ITAA 1936</i>	107
<i>Section 82KZMGB</i>	108
Market value rule applies to 'CGT events'	109
Anti-overlap provisions	112
<i>Section 118-20</i>	112
Amounts received by initial participants where the Project trees are thinned	114
<i>Section 6-5</i>	114
Borrowing costs	116
<i>Section 25-25</i>	116

Application fee payable under a Terms Payment Agreement	119
<i>Section 40-880</i>	119
Section 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion	121
Section 82KL – recouped expenditure	124
Part IVA – general tax avoidance provisions	125
Appendix 2 – Detailed contents list	128

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2003/12; TR 97/7; TR 97/11;
TR 98/22; TR 2000/8;
TR 2007/6; PR 2006/152

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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- ITAA 1936 82KZMG(3)

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- ITAA 1936 177C
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- ITAA 1997 6-5
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- ITAA 1997 8-1
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PR 2007/87

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NO: 2006/12521

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ timber