



PR 2010/8 - Income tax: Rewards Group Premium Timber Project 2010

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 This document has changed over time. This is a consolidated version of the ruling which was published on *14 April 2010*



Product Ruling

Income tax: Rewards Group Premium Timber Project 2010

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	12
Ruling	18
Scheme	50
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	97
Appendix 2:	
Detailed contents list	143

ⓘ 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives 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. The Commissioner recommends 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.

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 Product Ruling relates. In this Product Ruling this scheme is referred to as the scheme, the 'Rewards Group Premium Timber Project 2010', or simply as 'the Project'.
2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Product Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Product Ruling, terms defined in the Project agreements have been capitalised.

Class of entities

3. 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.
4. 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 in this Product Ruling as Growers.
5. Growers are those entities that:
 - meet the definition of 'initial participant' in subsection 394-15(5); and
 - are accepted to take part in the scheme specified below on or after the date this Product Ruling is made and on or before 30 June 2010.
6. A Grower will have executed the relevant Project Agreements set out in paragraph 50 of this Ruling on or before 30 June 2010 and will hold a 'forestry interest' in the Project.
7. The class of entities who can rely on this Product Ruling does **not** include:
 - entities who are accepted into this Project before the date of this Product Ruling or after 30 June 2010;
 - entities who participate in the scheme through offers made other than through the Product Disclosure Statement or who enter into an undisclosed arrangement with:
 - the promoter or a promoter associate; or

- an independent adviser,
that is interdependent with scheme obligations and/or
scheme benefits (which may include tax benefits or
harvest returns) in any way; or
- entities whose Subscription Money, including all loan
moneys, are not paid in full to Rewards Projects Ltd by
30 June 2010, either by the Grower and/or on the
Grower's behalf by a lending institution; or
- entities who enter into finance agreements with
Greentree Capital Pty Ltd (Greentree) outside the
terms specified in paragraph 94 of this Ruling.

Superannuation Industry (Supervision) Act 1993

8. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Australian Taxation Office (ATO) 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.

Qualifications

9. 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 50 to 96 of this Ruling.

10. 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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Date of effect

12. This Product Ruling applies prospectively from 14 April 2010, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 14 April 2010 to 30 June 2010 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 all income years up to the income year in which the scheme is terminated in accordance with the Constitution.

13. 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.

Changes in the law

14. 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.

15. 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

16. 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 ATO suggests that promoters and advisers ensure that investors are fully informed of any legislative changes after the Product Ruling is issued.

Goods and Services Tax

17. 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 Product Ruling as a Grower) to be entitled to claim input tax credits for the GST included in any creditable acquisition that it makes, it must be registered or required to be registered for GST and hold a valid tax invoice.

Ruling

Structure of the Project

18. The Rewards Group Premium Timber Project 2010 is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of Sandalwood and Teak Trees for felling in Australia.

19. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for an 'initial participant'¹ in the defined class of entities (see paragraphs 4 to 6 of this Ruling) who is accepted to participate in the 'forestry managed investment scheme' described at paragraphs 50 to 96 of this Ruling between 14 April 2010 and 30 June 2010 inclusive.

20. An entity that takes part in the Project as a 'subsequent participant'² is not covered by this Product Ruling but may request a private ruling on their participation in the Project. A 'subsequent participant' is an entity that does not meet the definition of 'initial participant' in subsection 394-15(5).

Carrying on a business

21. Although not relevant for the purposes of Division 394, a Grower (as described in paragraphs 4 to 6 of this Ruling) who takes out insurance over the Trees on their Woodlot(s) per clause 19 of the Constitution and who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Such Growers who are individuals will be subject to the operation of Division 35 (see paragraphs 45 to 48 and 132 to 138 of this Ruling).

Concessions for 'small business entities'³

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 Product Ruling.

¹ See subsection 394-15(5).

² See section 394-30.

³ The meaning of 'small business entity' is explained in section 328-110.

The '70% DFE rule' and the establishment of the trees**Section 394-35 and subsection 394-10(4)**

24. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by Rewards Projects Ltd. On the basis of that information, the Commissioner has decided that on 30 June 2010 it will be reasonable to expect that the '70% DFE rule'⁴ will be satisfied. The ATO may undertake review activities during the term of the Project to verify the information relied on for the purposes of the '70% DFE rule'.

25. The Product Ruling will only apply if Rewards Projects Ltd establishes all of the Trees that were intended to be established under the Project within 18 months of the end of the income year in which the first 'participant' in the Project is accepted.⁵ For this Project the Trees must be established by 31 December 2011.

26. In the context of this Project, the Trees will be established when they are planted on the land acquired for the purposes of the Project at the average rate of 1,250 trees per hectare for Teak and 1,400 trees plus 1,100 host trees per hectare for Sandalwood. Rewards Projects Ltd is required by section 394-10 of Schedule 1 of the *Taxation Administration Act 1953* (TAA) to notify the ATO if the Trees are not established by 31 December 2011.

Allowable deductions**Sections 8-5, 394-10 and 394-20 and Division 27**

27. A Grower in the Project can claim deductions, on a **per Woodlot** basis, for the amounts shown in the Table below that are paid to Rewards Projects Ltd (sections 8-5 and 394-10).

Fee	Amount	Income Year(s) deductible
Initial Fee	\$6,050 See Note (i)	2010
Maintenance Fee	13.42% of net Teak sales proceeds plus 13.53% of net Sandalwood sales proceeds See Note (i)	Any year in which this amount is paid See Note (ii)
Licence Fees	22.33% of net Teak sales proceeds plus 17.05% of net Sandalwood sales proceeds See Note (i)	Any year in which this amount is paid See Note (ii)
Pruning Fee (Teak)	See Notes (i) and (iii)	Any year in which this amount is paid See Note (iii)

⁴ The '70% DFE rule' is set out in section 394-35.

⁵ See subsection 394-10(4).

Harvest and related costs	Actual Cost (deducted from sale proceeds) See Note (i)	Any year in which this amount is paid See Note (ii)
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Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of the outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Growers will be notified by Rewards Projects Ltd of the years in which these amounts are paid. Harvest and thinnings are expected to occur from the year 2017.
- (iii) The Pruning Fee is payable in respect of each Harvest conducted on the Teak Block and is deducted from sale proceeds. The Pruning Fee is initially set at \$66 and will be indexed from 1 July 2011.

28. The deductibility of these amounts remains subject to a requirement that a CGT event⁶ does not happen in relation to the Grower's 'forestry interest' before 1 July 2014 (see paragraphs 32 to 34 of this Ruling).

29. Each amount is deductible in the income year in which it is paid, or is paid on behalf of the Grower (subsection 394-10(2) and section 394-20). This requires cash to flow from the Grower, or from another entity on the Grower's behalf, to Rewards Projects Ltd bank account in the year in which the deduction is claimed. Any form of payment that does not involve the movement of cash into Rewards Projects Ltd bank account will not qualify for a deduction under subsection 394-10(2).

30. Where a Grower does not fully pay an amount, or it is not fully paid on their behalf in an income year, it is deductible only to the extent to which it has been paid. Any unpaid amount is then deductible in the income year or income years in which it is actually paid.

31. Amounts that are allowable deductions under Division 394 cannot also be claimed as deductions under section 8-1 (section 8-10).

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

Subsections 394-10(5) and 395-10(6) of the ITAA 1997 and section 170 of the ITAA 1936

32. A deduction for the Initial Fee is not allowable where a 'CGT event' happens in relation to the 'forestry interest' of a Grower before 1 July 2014 (subsection 394-10(5)).

⁶ Defined in section 995-1.

33. Where deductions for these amounts have already been claimed by a Grower, the Commissioner may amend their assessment at any time within two years of the 'CGT event' happening (subsection 394-10(6)). The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936.

34. Growers whose deductions are disallowed because of subsection 394-10(5) are still required to include in assessable income the market value of the 'forestry interest' at the time of the 'CGT event' or the decrease in the market value of the 'forestry interest' as a result of the 'CGT event'.

Insurance costs

Section 8-1

35. Any amounts incurred by a Grower to insure their Trees will be deductible under section 8-1. Deductions for insurance premiums are allowable in the year in which the insurance costs are incurred. The Responsible Entity will advise the Grower each year of the cost of the insurance premiums.

36. This Product Ruling only applies if the insurance provided is on the same terms as described in the Plantation Timber insurance policy provided with the application for a Product Ruling.

Borrowing costs

Section 25-25

37. The Loan Application Fee of \$250 or 0.25% of the Finance Application Amount payable to Greentree is a borrowing expense and is deductible under section 25-25.

38. The deduction for the borrowing expense is spread over the period of the loan or 5 years whichever is shorter on a straight line basis from the date the loan begins.

39. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Greentree under the finance arrangement described at paragraph 94 is outside the scope of this Product Ruling.

Assessable income, 'CGT events' and the 'forestry interests' of Growers who are 'initial participants'***Sections 6-10, 394-25 and 17-5***

40. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁷ – see paragraph 43 of this Ruling) happens to a 'forestry interest' held by a Grower in this Project, the market value of the 'forestry interest', or the decrease in the market value of the 'forestry interest', is included in the assessable income of the Grower (sections 6-10 and 394-25), less any GST payable on those proceeds (section 17-5).

41. The relevant amount is included in the Grower's assessable income in the income year in which the 'CGT event' happens (subsection 394-25(2)).

42. 'CGT events' for these purposes include those relating to:

- a **clear-fell harvest of all or part of the trees** grown under the Project;
- the **sale, or any other disposal** of all or part of the 'forestry interest' held by the Grower; or
- any other 'CGT event' that results in a reduction of the market value of the 'forestry interest' held by the Grower.

Amounts received by Growers where the Project trees are thinned and where insurance proceeds are paid***Sections 6-5 and 17-5***

43. An amount received by a Grower in respect of a thinning of the trees grown in this Project is not received as a result of a 'CGT event' and is not otherwise assessable under Division 394. The amount is a distribution of ordinary income that arises as an incident of a Grower holding a 'forestry 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) less any GST payable on those proceeds (section 17-5).

44. Similarly insurance proceeds are ordinary income and assessable under section 6-5 in the year in which the amounts are derived less any GST payable on those proceeds (section 17-5).

⁷ 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.

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

Section 35-55 – annual exercise of Commissioner’s discretion during the period beginning with the 2009-10 income year and concluding with the 2027-28 income year

45. For each of the income years from 2009-10 to 2027-28, the Commissioner will exercise the discretion in subsection 35-55(1) once the following conditions are satisfied for the year concerned:

- the Grower carried on their business of afforestation during the income year; and
- the business activity that is carried on is not materially different to that in the scheme described in this Product Ruling; and
- the Grower has incurred a taxation loss for the income year from carrying on that business activity.

46. If these conditions are met for a given income year, the Commissioner will exercise the discretion for that year under:

- paragraph 35-55(1)(b) for a Grower in the Project who satisfies the income requirement in subsection 35-10(2E); and
- paragraph 35-55(1)(c) for a Grower in the Project who does not satisfy the income requirement in subsection 35-10(2E).

47. If the Commissioner determines that the discretion will not be exercised for a particular income year or income years, the Grower will be informed of that decision and the reasons. In any income year where the discretion is not exercised, losses incurred by a Grower will be subject to the loss deferral rule in section 35-10 and the Grower will not be able to offset the losses from the Project against other assessable income.

48. The issue of this Product Ruling of itself does not constitute the exercise of the Commissioner’s discretion in subsection 35-55(1) for any income year.

Prepayment provisions and anti-avoidance provisions

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

49. Where a Grower is accepted to participate in the Project set out at paragraphs 50 to 96 of this Ruling, the following provisions of the ITAA 1936 have application as indicated:

- insurance costs paid by a Grower, in accordance with paragraphs 35 and 36 of this Ruling, do not fall within the scope of sections 82KZM, 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 Product Ruling.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 23 November 2009 and additional correspondence including emails received 8 February 2010, 18 March 2010, 19 March 2010, 22 March 2010, 23 March 2010, 26 March 2010 and 31 March 2010;
- Draft Product Disclosure Statement for the Rewards Group Premium Timber Project 2010, received 31 March 2010;
- Draft Constitution for the Rewards Group Premium Timber Project 2010, received 8 February 2010;
- Draft Compliance Plan for the Rewards Group Premium Timber Project 2010, received 23 November 2009;
- Draft Head Lease between the landowner (Lessor) and Rewards Projects Ltd (as Lessee), received 23 November 2009;
- Draft **Licence Agreement** between Rewards Projects Ltd (as Responsible Entity) and the Grower, received 23 November 2009;
- Draft **Management Agreement** between Rewards Projects Ltd (as Responsible Entity) and the Grower, received 23 November 2009;
- Draft Operations Agreement between Rewards Projects Ltd and Rewards Management Pty Ltd, received 23 November 2009;
- Draft Loan Agreement for 12 month interest free loan from Greentree Capital Pty Ltd, received 23 November 2009; and
- **Plantation Timber Insurance Policy**, received 23 November 2009.

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

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

52. The documents highlighted are those that a Grower may enter into. For the purposes of describing the scheme to which this Product 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. The effect of these agreements is summarised as follows.

Overview

53. The main features of the Rewards Group Premium Timber Project 2010 are as follows:

Species of trees to be planted under the scheme	<i>Tectona grandis</i> (Teak) and <i>Santalum spicatum</i> (West Australian Sandalwood).
Locations	Far north Queensland (Teak) and West Australian wheatbelt region (Sandalwood)
Term of the Project	Approximately 20 years
Number of hectares offered for cultivation	2,250
Size of each 'forestry interest'	0.25 hectares
Minimum allocation of 'forestry interests' per Grower	One
Date all trees are due to be planted on scheme land	31 December 2011
Number of trees established	322 trees are established per Woodlot consisting of 112 Teak trees and 210 Sandalwood trees
Initial cost per Woodlot	\$6,050
Other costs	Licence and Maintenance Fees payable in arrears from the net sales proceeds of each harvest Pruning Fees (Teak only) payable from sale proceeds Harvest and related costs payable from sale proceeds Optional insurance costs

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

55. The Project will involve establishing, tending, felling and harvesting Teak and Sandalwood trees for the purpose of selling the timber and/or timber products.

56. Teak Blocks will be located in far north Queensland close to the timber processing centre of Ravenshoe and the ports of Cairns, Mourilyan and Townsville. Sandalwood Blocks will be located in the central wheatbelt region of Western Australia within proximity to the port of Fremantle.

57. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 9,000 Woodlots (forestry interests) of 0.25 hectares, which equates to a total of 2,250 hectares.

58. Each Woodlot will comprise a Teak Block of 0.1 hectares and a Sandalwood Block of 0.15 hectares. Growers accepted in the Project will be granted a licence over the Woodlots.

59. Rewards Projects Ltd will enter into an agreement to lease land from the landowners on which the Plantation will be established. Project land must meet the requirements set out by the Independent Forester in the PDS.

60. An entity that participates in the Project as a Grower will do so by acquiring a minimum of one 'forestry interest' in the Project on or before 30 June 2010. There is no minimum subscription for the Project.

61. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Rewards Projects Ltd to enter into, on behalf of the Grower, a Licence Agreement and a Management Agreement and any other documents required to hold an interest in the Project.

62. For the purposes of this Product Ruling, Applicants who are accepted to participate in the Project and whose agreements (see paragraph 61 of this Ruling) are executed and Subscription Money is paid by 30 June 2010 will become Growers in the 2010 Project.

Constitution

63. The Constitution establishes the Project and operates as a deed binding all Growers and Rewards Projects Ltd. The Constitution sets out the terms and conditions under which Rewards Projects Ltd agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project. Rewards Projects Ltd will keep a register of Growers accepted into the Project.

64. To acquire an interest in the Project, an entity must make an application for 'forestry interests' in accordance with clause 3. Growers must complete and sign the Application Form provided in the PDS and pay the Subscription Money in a form acceptable to the Responsible Entity.

65. Under clause 8.2 of the Constitution, Rewards Projects Ltd holds the Subscription Money on bare trust in a Subscription Fund and will deposit all funds received from applicants in a Project bank account.

66. Once Rewards Projects Ltd has accepted the application, all of the Project documents have been executed and the conditions set out in clause 3.3 are satisfied, the Subscription Money may be released and applied against the Project Fees due from the Grower.

67. In summary, the Constitution also sets out provisions relating to:

- the general functions, powers and duties of the Responsible Entity (clause 6);
- complaints and dispute resolution (clause 12);
- distributions from the Fund (clause 11);
- provisions relating to termination (clause 14); and
- transfer of Grower's interests (clause 17).

68. The Constitution also provides for optional insurance cover against loss or damage to the Trees. If requested by the Grower, the Responsible Entity will endeavour to procure insurance cover against destruction or damage of the Grower's Woodlot by fire and other usual risks (clause 19.1).

69. For the purpose of this Product Ruling only Growers who, from the time of planting until the end of the term of the Project, take out insurance in respect of the Trees against damage or destruction in terms of clause 19 of the Constitution for the Project, will be considered to be carrying on a business. Whether insurance is taken out or not will have no bearing on the deductibility under Division 394 of the amounts shown in the Table at paragraph 27 of this Ruling and the deductibility of borrowing costs shown at paragraphs 37 to 39 of this Ruling.

Compliance Plan

70. As required by the Corporations Act, Rewards Projects Ltd, as Responsible Entity, has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Rewards Projects Ltd manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease

71. The Responsible Entity (Lessee) will enter into a lease with the owner of the Project land for the term of the Project. The Responsible Entity is granted a lease to establish, maintain and harvest the Plantation.

72. Under the lease, the lessor confirms its consent to the granting of licences by the Lessee to Growers to use the Woodlots for the purposes of the Project.

73. Under the Lease, the Responsible Entity must pay the Rent to the Lessor in the amount and frequency as specified in the Lease.

Licence Agreement

74. Growers participating in the scheme will enter into a Licence Agreement with Rewards Projects Ltd in its capacity as the Responsible Entity of the Project. Growers are granted a Licence to use their Woodlot(s) for the purpose of cultivating and harvesting their trees upon the terms and conditions set out in the Licence.

75. The Licence will commence on the date the Grower's application is accepted under the PDS and will continue until the completion of the final harvest or the final distribution of receipts to Growers in approximately 20 years.

76. Under clause 2.3 the Grower is entitled to the Trees planted on the Woodlot and the Timber from the Trees until all the Trees have been harvested.

Management Agreement

77. The Management Agreement is annexed to the Constitution as Schedule 1. Under the Management Agreement, Rewards Projects Ltd as Responsible Entity is appointed to carry out the Initial Services and Ongoing Services, on behalf of each Grower.

78. The Initial Services (Annexure A) are:

- ensure that the Woodlots are ready for planting, including ripping, mounding and herbicide spraying (if required);
- for the Sandalwood Block, supply sufficient Host Tree seedlings and Sandalwood seed and plant the Host Trees and sow the Sandalwood seed to the specifications recommended in the Management Plan; and
- for the Teak Block, supply sufficient tissue culture Teak plantlets, grow out the Teak plantlets in the nursery and during the wet season, plant the Teak plants to the specifications recommended in the Management Plan.

79. The Manager shall complete the Initial Services during the Initial Period, which is 18 months commencing on 1 July 2010, that is, by 31 December 2011.

80. The Ongoing Services (Annexure B) will be provided throughout the Term of the Agreement and include the following:

- supervise and secure management of all works on the Plantation;
- within 12 months of planting and sowing seeds, conduct a survival count and replant or resow (as the case may be) the Trees, Host Trees and seeds to ensure there is an average stocking per hectare of 1,125 Teak Trees, 1,100 Host Trees and 1,400 Sandalwood seedlings;
- within 12 months of any harvest on the Teak Block, prune the remaining trees;
- insure the Plantation against public risk for an amount of not less than \$5,000,000 during the Term of the Project;
- manage each Harvest in accordance with clause 6; and
- manage the sale of Harvested Timber in accordance with clause 7.

Operations Agreement

81. Rewards Projects Ltd will subcontract the management services under an Operations Agreement with Rewards Management Pty Ltd as the Manager. The Operations Agreement requires the Manager to carry out the Initial Services and the Ongoing Services in accordance with sound silvicultural and forestry practices adopted within the forestry industry and substantially in accordance with the Project's Management Plan (clause 2.1).

Harvesting and distribution of proceeds

82. The Grower is entitled to the Teak and Sandalwood trees planted on the Woodlot and has a right to the Timber from those trees. Harvesting will take place as and when deemed appropriate by the Responsible Entity in producing the best overall result for the Grower. The Responsible Entity expects to conduct thinning harvests of Trees on a progressive basis between the ages of 5 and 18 years with the final harvest to take place in the final year of the Project.

83. The proceeds from sale of the Grower's Timber will be paid direct to the Responsible Entity who must deposit them into a Proceeds Fund. From each Grower's share, the Responsible Entity will pay the costs of harvest and sale as advised by the Manager plus any outstanding fees or amounts owing by the Growers to the Responsible Entity. The balance will then be distributed to the Growers on a proportionate basis.

Fees

84. Under the terms of the Management Agreement, the Licence Agreement and the Constitution, a Grower will make payments as described below on a per 'forestry interest' basis:

Initial Fee

85. The Project has an upfront Initial Fee of \$6,050 which represents the total cost for establishment and planting of each Woodlot (Item 2 of the Schedule to the Management Agreement).

Harvest Costs

86. Under clause 6.3 of the Management Agreement, the Responsible Entity will deduct the Grower's Share of all costs of and incidental to Harvest out of the Grower's Share of the proceeds of sale of the relevant Harvest.

Licence Fee

87. The Licence Fee payable by the Grower is equal to 22.33% and 17.05% of the Grower's net sales proceeds from each harvest of Teak and Sandalwood respectively, after deducting the costs referred to in paragraph 86 of this Ruling (Item 4 of the Schedule to the Licence Agreement).

Maintenance Fee

88. At each relevant harvest, the Grower is required to pay a Maintenance Fee for Ongoing Services to the Responsible Entity. The amount payable is equal to 13.42% and 13.53% of the Grower's net sales proceeds from each harvest of Teak and Sandalwood respectively, after deducting the costs referred to in paragraph 86 of this Ruling (Item 3 of the Schedule to the Management Agreement).

Pruning Fee

89. The Grower is required to pay a Pruning Fee from the sales proceeds of each relevant harvest from the Teak Block. The amount payable to the Responsible Entity will initially be set at \$66 and will be indexed annually from 1 July 2011 (Item 4 of the Schedule to the Management Agreement).

Optional Insurance

90. Under clause 19 of the Constitution a Grower may elect to take out insurance to insure their Woodlot(s) against fire or other usual risks. The Grower is responsible for payment of the premiums under the insurance policy. The Responsible Entity will advise Growers each year of the cost of the insurance premiums.

Finance

91. To finance all or part of the cost of their 'forestry interest' a Grower can enter into a finance arrangement with Greentree or alternatively borrow from an independent lender external to the Project.

92. The finance offered by Greentree is set out below and only those arrangements are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with Greentree that materially differs from that set out in the documentation provided with the application for this Product Ruling.

93. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling. A Grower cannot rely on any part of this Product Ruling if the Subscription Money is not paid in full on or before 30 June 2010 by the Grower or, on the Grower's behalf by a lending institution.

Finance offered by Greentree

94. The full terms of the Loan Agreement offered by Greentree are included in the PDS at section 9 of the Application Form. The Loan Agreement provides the following features:

- the financier will take security over the Grower's Woodlot;
- a Loan Application Fee of 0.25% of the loan amount is payable on the First Instalment Date which is approximately one month after the Acceptance Date, subject to a minimum amount of \$250;
- the Loan Term is 12 months;

- the loan is interest free except that interest will be charged on overdue amounts at the Base Rate plus 4.5% interest per annum. Default interest will be calculated daily and accrued monthly; and
- monthly payments of \$504.16 are due in the manner indicated by the Finance Application and in accordance with the Loan Agreement, commencing on the First Instalment Date.

95. Greentree will only provide loans to Growers where it has sufficient funds to do so.

96. This Product 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 Greentree are involved or become involved in the provision of finance to Growers for the Project.

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.*

Structure of the Project

97. In return for payment of the Initial Fee and the other fees and expenses required during the term of the Project under the Management Agreement and the Licence Agreement, Growers will hold a 'forestry interest' in a 'forestry managed investment scheme'. The Project qualifies as a 'forestry managed investment scheme' because its purpose is for 'establishing and tending trees for felling in Australia' (see subsection 394-15(1)).

98. Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Grower a right to a share in the proceeds of the thinning and harvest of the trees grown on the Project land. That share of proceeds is determined using the number of 'forestry interests' held by a Grower as a proportion of all 'forestry interests' held by 'participants'⁸ in the Project.

Is the Grower carrying on a business?

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

100. More recently, and in relation to a managed investment scheme similar to that which is the subject of this Product Ruling, the Full Federal Court in *Hance v. FC of T*; *Hannebery v. FC of T* [2008] FCAFC 196; 2008 ATC 20-085 applied these principles to conclude that 'Growers' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

101. Application of these principles to the arrangement set out above leads to the conclusion that a Grower (as described in paragraphs 4 to 6 of this Ruling), who takes out insurance over the Trees on their Woodlot(s) and who stays in the Project until its completion will be carrying on a business of primary production involving afforestation activities.

⁸ The term 'participant' is defined in subsection 394-15(4).

Allowable deductions***Sections 8-5, 12-5, 394-10 and 394-20***

102. Section 8-5 allows certain specific deductions to be claimed against the assessable income of a taxpayer. The list of specific deductions is shown in a table in section 12-5 and includes payments under a 'forestry managed investment scheme' that meet the requirements of subsection 394-10(1).

The '70% DFE rule'***Paragraph 394-10(1)(c) and section 394-35***

103. The threshold test for Growers in the Project to be entitled to deductions under subsection 394-10(1) is the '70% DFE rule' in paragraph 394-10(1)(c). Under that rule it must be reasonable to expect that on 30 June 2010, the amount of 'direct forestry expenditure'⁹ under the scheme will be no less than 70% of the amount of payments under the scheme.¹⁰

104. The amount of all 'direct forestry expenditure' is the amount of the net present value of all 'direct forestry expenditure' that the Responsible Entity, as 'forestry manager'¹¹ of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

105. The 'amount of payments under the scheme' is the amount of the net present value of all amounts (that is, the fees and expenses) that all current and future 'participants' in the scheme have paid or will pay under the scheme (subsection 394-35(3)).

106. Both of the above amounts are determined as at 30 June 2010 taking into account

- the timing requirements in subsections 394-35(4) and 394-35(5);
- any amounts that can reasonably be expected to be recouped (subsection 94-35(6));
- the discount rate in subsection 394-35(7); and
- the market value rule in subsection 394-35(8).

107. Applying all of these requirements to the information provided by the Responsible Entity of the Project, the Commissioner has determined that the Project will satisfy the '70% DFE rule' on 30 June 2010.

⁹ See section 394-45.

¹⁰ See subsection 394-35(1) and section 394-40.

¹¹ Defined in section 394-15(2).

The other elements for deductibility under subsection 394-10(1)

108. The requirement of paragraph 394-10(1)(d) that Growers in the Project not have day to day control over the operation of the Project is clear from the Project Agreements as are the alternative elements of paragraph 394-10(1)(e) relating to the number of Growers in the scheme and the Responsible Entity's role in other managed investment schemes.

109. The final requirement for deductibility requires all the Project trees to be established within 18 months of 30 June 2010 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Product Ruling by the Responsible Entity indicates that all the trees required to be established under the scheme will be planted on the Project land by 31 December 2011.

110. Accordingly, subject to the qualifications set out below, amounts paid by Growers to the Responsible Entity in relation their 'forestry interests' satisfy all requirements of subsection 394-10(1). The amounts are allowable deductions in the income year in which they are paid (subsection 394-10(2)).

111. Where a Grower does not fully pay an amount, or the amount is not fully paid on their behalf in an income year (see section 394-20), it is deductible only to the extent to which it has been paid. The unpaid balance is then deductible in the income year or income years in which it is actually paid. This may occur, for example, if all or part of the amount is borrowed and the financier fails to transfer the funds to the account of the 'forestry manager' on or before 30 June in an income year.

Loss of deductions previously allowed under subsection 394-10(1)

112. Two situations may lead to a loss of deductions previously allowed to Growers.

113. The first of these situations will occur if the Responsible Entity fails to establish the trees on the Project land within 18 months. Where this occurs the Responsible Entity is required to notify the Commissioner within 3 months of the end of the 18 month period (section 394-10 of Schedule 1 to the TAA).

114. The second situation where a Grower may have deductions disallowed is where a 'CGT event' happens to their 'forestry interest' within 4 years from 30 June of the income year they paid an amount under the scheme, for example, the Initial Fee (see subsection 394-10(5)).

115. For the purposes of this provision, the Commissioner is able to amend the assessment of a Grower within 2 years of the relevant 'CGT event' happening. The Commissioner's power to amend in these circumstances applies despite section 170 of the ITAA 1936 (subsection 394-10(6) of the ITAA 1997).

116. Where a 'CGT event' happens to the 'forestry interest' of a Grower within 4 years, the market value of the forestry interest at the time of the 'CGT event' or the decrease in the market value of the 'forestry interest' as a result of the 'CGT event' is still included in the assessable income of the Grower by section 394-25. The amount must be included in assessable income even where an amendment has disallowed or may disallow the deductions previously allowed under section 394-10.

Prepayment provisions

Sections 82KZL to 82KZMF

117. 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 that will not be wholly done within the same year of income as the year in which the expenditure is incurred. For schemes such as this Project, the main operative provisions are sections 82KZMD and 82KZMF of the ITAA 1936.

118. However, subsection 394-10(7) specifically provides that sections 82KZMD and 82KZMF of the ITAA 1936 do not affect the timing of amounts deductible under section 394-10 of the ITAA 1997.

119. Accordingly, under the scheme to which this Product Ruling applies, only deductions for the payment of insurance costs will potentially fall within the prepayment provisions. However, the conditions applying to the insurance policy to which this Product Ruling applies do not require any prepayment of insurance premiums over the term of the Project. Accordingly, the prepayment provisions have no application to Growers in this Project.

120. If a Grower chooses to prepay insurance premiums, that Grower may request a private ruling on how the prepayment provisions will affect the timing of their deduction.

Borrowing costs

Section 25-25

121. 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)).

122. In this Project the Loan Application Fee payable to Greentree 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.

123. The deduction for the borrowing expense is spread over the shorter of the period of the loan or 5 years (subsection 25-25(4)).

Assessable income, 'CGT events' and the 'forestry interests' of Growers who are 'initial participants'**Sections 6-10, 10-5 and 394-25**

124. Section 6-10 includes in assessable income amounts that are not ordinary income. These amounts, called statutory income, are listed in the table in section 10-5 and include amounts that are included in the assessable income of 'initial participants' of a 'forestry managed investment scheme' by subsection 394-25(2).

Subsection 394-25(2)

125. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)¹² happens to a 'forestry interest' held by a Grower in this Project, subsection 394-25(2) includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted an amount under section 394-10; or
- the Grower would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 28 to 34 and paragraphs 112 to 114 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to 'CGT events'

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

- no longer holds the 'forestry interest'; or
- otherwise – where the Grower continues to hold the 'forestry interest', but there is a decrease in the market value of the 'forestry interest',

then the market value of the 'forestry interest' at the time of the event, or the reduction of the market value of the 'forestry interest' as a result of the event, is included in the assessable income of the Grower in the income year in which the 'CGT event' happens (subsection 394-25(2)). A market value rule applies rather than the amount of money actually received from the 'CGT event' (subsection 394-25(3)). However, the market value and the actual amount of money received may be the same.

127. The market value amount included in the assessable income of a Grower is the value of the 'forestry interest' just before the 'CGT event', or where the Grower continues to hold their interest after the event, the amount by which the market value of the 'forestry interest' is reduced as a result of the 'CGT event' (subsection 394-25(2)).

¹² A thinning under this scheme is not a 'CGT event'.

128. Section 394-25 will apply where the 'forestry interest' is sold, is extinguished, or ceases, and will include 'CGT events' such as a full or partial sale of the 'forestry interest' or from a full or partial clear-fell harvest of the trees grown under the Project.

Section 6-5 – amounts received by Growers where the Project trees are thinned and where insurance proceeds are paid

129. Section 394-25 specifically excludes from the operation of Division 394 a 'CGT event' that happens in respect of a thinning (see paragraph 394-25(1)(c)).

130. Thinning amounts received by a Grower in this Project do not arise as a result of a 'CGT event' and are not otherwise assessable under Division 394. 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 a 'forestry interest' in the Project. It is an item of ordinary income and is assessable under section 6-5 in the year in which it is derived.

131. Similarly an amount received by way of insurance proceeds, is ordinary income and is assessable under section 6-5 in the income year in which the amount is derived.

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

132. Based on information provided with the application for this Product Ruling, a Grower accepted into the Project in the 2009-10 income year who carries on a business of afforestation individually (alone or in partnership) is expected to incur losses from their participation in the Project which will be subject to Division 35.¹³ These losses will be subject to the loss deferral rule in section 35-10 unless an exception applies or, for each income year in which losses are incurred, the Commissioner exercises the discretion in subsection 35-55(1) on 30 June of that specific income year.

133. The exceptions to the loss deferral rule depend upon the circumstances of individual Growers and are outside the scope of this Product Ruling.

134. The Commissioner will apply the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner's discretion when exercising the discretion.

¹³ Division 35 does not apply to Growers who do not carry on a business or who carry on a business other than as individuals (alone or in partnership).

135. Where a Grower with income for Non-commercial Loss (NCL) purposes of less than \$250,000 (that is, the Grower satisfies the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(b) is exercised for that income year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the 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 afforestation industry, the Grower's business activity will satisfy one of the four tests set out in Division 35 or produce assessable income for an income year greater than the deductions attributable to it for that income year (apart from the operation of subsections 35-10(2) and 35-10(2C)).

136. Where a Grower with income for NCL purposes of \$250,000 or more (that is, the Grower does not satisfy the income requirement in subsection 35-10(2E)) incurs a loss in an income year from carrying on their business activity in a way that is not materially different to the scheme described in this Product Ruling, and the discretion in paragraph 35-55(1)(c) is exercised for that income year, the Commissioner will be satisfied that:

- it is because of its nature that the business activity of the Grower will not produce assessable income greater than the deductions attributable to it; and
- there is an objective expectation that within a period that is commercially viable for the afforestation industry, the Grower's business activity will produce assessable income for an income year greater than the deductions attributable to it for that income year (apart from the operation of subsections 35-10(2) and 35-10(2C)).

137. A Grower will satisfy the income requirement in subsection 35-10(2E) where the sum of the following amounts is less than \$250,000:

- taxable income for that income year (ignoring any loss arising from participation in the Project or any other business activity);
- total reportable fringe benefits for that income year;
- reportable superannuation contributions for that income year; and
- total net investment losses for that income year.

138. In each individual income year where the Commissioner's discretion is exercised a Grower within either paragraph 135 or paragraph 136 of this Ruling who would otherwise be required to defer a loss arising from their participation in the Project under section 35-10 until a later income year is able to offset that loss against their other assessable income.

Section 82KL – recouped expenditure

139. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-5 of the ITAA 1997.

Part IVA – general tax avoidance provisions

140. 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).

141. The Rewards Group Premium Timber Project 2010 will be a 'scheme' and a Grower will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraphs 27 to 39 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.

142. Growers to whom this Product Ruling applies will derive assessable income from holding or disposing of their 'forestry interest' in the Project. 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 Product 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 Growers will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Class of entities	3
Superannuation Industry (Supervision) Act 1993	8
Qualifications	9
Date of effect	12
Changes in the law	14
Note to promoters and advisers	16
Goods and Services Tax	17
Ruling	18
Structure of the Project	18
Carrying on a business	21
Concessions for 'small business entities'	22
The '70% DFE rule' and the establishment of the trees	24
<i>Section 394-35 and subsection 394-10(4)</i>	24
Allowable deductions	27
<i>Sections 8-5, 394-10 and 394-20 and Division 27</i>	27
'CGT event' within 4 years for Growers who are 'initial participants'	32
<i>Subsections 394-10(5) and 395-10(6) of the ITAA 1997 and section 170 of the ITAA 1936</i>	32
Insurance costs	35
<i>Section 8-1</i>	35
Borrowing costs	37
<i>Section 25-25</i>	37
Assessable income, 'CGT events' and the 'forestry interests' of Growers who are 'initial participants'	40
<i>Sections 6-10, 394-25 and 17-5</i>	40
Amounts received by Growers where the Project trees are thinned and where insurance proceeds are paid	43
<i>Sections 6-5 and 17-5</i>	43
Division 35 – deferral of losses from non-commercial business activities	45

<i>Section 35-55 – annual exercise of Commissioner’s discretion during the period beginning with the 2009-10 income year and concluding with the 2027-28 income year</i>	45
Prepayment provisions and anti-avoidance provisions	49
<i>Sections 82KZM, 82KZME, 82KZMF, 82KL and Part IVA</i>	49
Scheme	50
Overview	53
Constitution	63
Compliance Plan	70
Head Lease	71
Licence Agreement	74
Management Agreement	77
Operations Agreement	81
Harvesting and distribution of proceeds	82
Fees	84
<i>Initial Fee</i>	85
<i>Harvest Costs</i>	86
<i>Licence Fee</i>	87
<i>Maintenance Fee</i>	88
<i>Pruning Fee</i>	89
<i>Optional Insurance</i>	90
Finance	91
Finance offered by Greentree	94
Appendix 1 – Explanation	97
Structure of the Project	97
Is the Grower carrying on a business?	99
Allowable deductions	102
<i>Sections 8-5, 12-5, 394-10 and 394-20</i>	102
The ‘70% DFE rule’	103
<i>Paragraph 394-10(1)(c) and section 394-35</i>	103
<i>The other elements for deductibility under subsection 394-10(1)</i>	108
<i>Loss of deductions previously allowed under subsection 394-10(1)</i>	112
Prepayment provisions	117
<i>Sections 82KZL to 82KZMF</i>	117

Borrowing costs	121
<i>Section 25-25</i>	121
Assessable income, 'CGT events' and the 'forestry interests' of Growers who are 'initial participants'	124
<i>Sections 6-10, 10-5 and 394-25</i>	124
<i>Subsection 394-25(2)</i>	125
<i>Market value rule applies to 'CGT events'</i>	126
Section 6-5 – amounts received by Growers where the Project trees are thinned and where insurance proceeds are paid	129
Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion	132
Section 82KL – recouped expenditure	139
Part IVA – general tax avoidance provisions	140
Appendix 2 – Detailed contents list	143

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7, TR 97/11, TR 98/22,
TR 2007/6

Subject references:

- 4 year holding period
- 70 per cent DFE rule
- DFE
- direct forestry expenditure
- forestry interest
- forestry MIS
- interest expenses
- market value substitution rule
- payments under the scheme
- producing assessable income
- product rulings
- reasonable expectation
- tax avoidance
- taxation administration

Legislative references:

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