


TD 2009/D15 - Income tax: will a deduction remain allowable under subsection 394-10(1) of the Income Tax Assessment Act 1997 where a CGT event happens in relation to a participant's forestry interest in a forestry managed investment scheme within 4 years after the end of the income year in which the participant first pays an amount under the scheme (subsection 394-10(5) of that Act)?

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Draft Taxation Determination

Income tax: will a deduction remain allowable under subsection 394-10(1) of the *Income Tax Assessment Act 1997* where a CGT event happens in relation to a participant's forestry interest in a forestry managed investment scheme within 4 years after the end of the income year in which the participant first pays an amount under the scheme (subsection 394-10(5) of that Act)?

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

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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.

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Ruling

1. No. A deduction is not allowable under subsection 394-10(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) where a CGT event happens in relation to the participant's forestry interest within 4 years after the end of the income year in which the participant first pays an amount under the scheme (subsection 394-10(5) of the ITAA 1997).

2. However, where a business is or was being carried on, the amount paid, which subsequently fails the test in Division 394 of the ITAA 1997 (Division 394), may nonetheless still be allowable under section 8-1(1)(b) of the ITAA 1997. That is, notwithstanding the failure to satisfy the tests in the more specific provisions in Division 394 a deduction may still be allowable under section 8-1 of the ITAA 1997, the general deduction provision. The timing of that deduction will be governed by the requirements of Subdivision H of Division 3 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) (Subdivision H).

3. Most arrangements with features initially designed to satisfy the provisions of Division 394 will not meet the requirements of section 82KZMG of the ITAA 1936 in Subdivision H, primarily because the agreements will have an establishment period greater than 12 months. Accordingly, and subject to Section 82KZME of the ITAA 1936, the timing of deductions is determined by 82KZMF of the ITAA 1936. This will be over the relevant eligible service period as defined in subsection 82KZL(1) of the ITAA 1936.

Example

4. *Dane paid amounts under a forestry managed investment scheme during the 2008 financial year. The content of the agreements indicates that a business is also being carried on. During 2009, as a result of the liquidation of the forestry manager, Dane gave up all rights under his forestry interest in return for a share of proceeds from asset realisations. This is a CGT event (either A1 for C2). As a result of the CGT event, subsection 394-10(5) of the ITAA 1997 is failed, and there is no entitlement to claim the deduction for the amounts paid in the 2008 year under subsection 394-10(1) of the ITAA 1997. However, the market value of the consideration he received is included in Dane's assessable income. Moreover, as a business was being carried on, the amounts incurred would have been deductible under section 8-1 of the ITAA 1997 and subject to the operation of Subdivision H. Due to the contracted period within which trees were to be planted, section 82KZMG of the ITAA 1936 does not apply. Subject to section 82KZME of the ITAA 1936, section 82KZMF of the ITAA 1936 would apply to spread the amount paid over the relevant eligible service period.*

Class of persons

5. This draft Determination applies to participants in schemes that are either subject to a current product ruling, or were subject to a product ruling which has been withdrawn with effect from immediately before any material difference occurred.

Date of effect

6. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

Note

7. The Assistant Treasurer made an announcement on 21 October 2009 in media release No. 074 that:

The Rudd Government will amend [the] four-year holding period rule for forestry MIS to ensure that it cannot be failed for reasons genuinely outside an investor's control.

Commissioner of Taxation
28 October 2009

Appendix 1 – Explanation

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

Explanation

8. Under subsection 394-10(1) of the ITAA 1997, a deduction is allowed for amounts paid to acquire a forestry interest provided certain conditions are met.

Subsection 394-10(5) of the ITAA 1997 provides that you cannot deduct an amount under subsection 394-10(1) if you hold a forestry interest as an initial participant and a CGT event happens in relation to that interest within 4 years after the end of the income year in which you first pay an amount under the scheme (the 4 year rule).

9. However, where the conduct of the forestry managed investment scheme also constitutes the carrying on of a business, expenditure may be deductible under section 8-1 ITAA 1997 in the alternative. Note that in the event that a deduction was initially allowable under both provisions, section 8-10 of the ITAA 1997 would have operated to ensure that the deduction was allowed under the most appropriate provision. That is, if the deduction was to be allowed under Division 394 then section 8-10 would prevent the amount also being claimed under section 8-1. However, in the situation where a business is being carried on, where a deduction is not allowable under Division 394, (such as where a CGT event happens and the 4 year rule is breached), then a deduction may still be allowable under section 8-1 in respect of the expenditure.

10. Where agreements entered into are of a similar nature to those entered into by the taxpayers in *Hance v. FC of T*; *Hannebery v. FC of T* [2008] FCAFC 196; 2008 ATC 20-085 it is likely to be concluded that a business is being carried on. In *Commissioner of Taxation v. Sleight* 2004 ATC 4477 the business of the taxpayer was found to have commenced at the time of entering into the relevant agreements. Refer to the judgment of Hill J at paragraph 9 and 61.

11. The effect of Subdivision H will need to be considered in respect of any amounts allowable under section 8-1 of the ITAA 1997. Section 82KZMG of the ITAA 1936 will not apply to afforestation arrangements if the period for providing establishment services extends over the 18 month period envisaged by Division 394. If this is the case, then the more general rules under sections 82KZME and 82KZMF of the ITAA 1936 may apply, and any deduction would be spread over the eligible service period (as defined in subsection 82KZL(1) of the ITAA 1936).

Appendix 2 – Your comments

12. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

13. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- advance expenses & payments
- afforestation expenses
- forest operations
- forestry
- prepayments
- primary production

Legislative references:

- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 82KZMG
- ITAA 1997 8-1

- ITAA 1997 8-1(1)(b)

- ITAA 1997 8-10

- ITAA 1997 Div 394

- ITAA 1997 394-10(1)

- ITAA 1997 394-10(5)

Case references:

- Commissioner of Taxation v. Sleight [2004] FCAFC 94; (2004) 136 FCR 211; 2004 ATC 4477; (2004) 55 ATR 555
- Hance v. FC of T; Hannebery v. FC of T [2008] FCAFC 196; 2008 ATC 20-085

Other references:

- Sherry, N (Assistant Treasurer), Government to Provide Tax Certainty to Investors in Forestry Managed Investment Schemes, media release No. 074, Canberra, 21 October 2009

ATO references

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