

PR 2004/64 - Income tax: Ginkgo Australia Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 May 2004*



Product Ruling

Income tax: Ginkgo Australia Project

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Preamble

*The number, subject heading, **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

No guarantee of commercial success

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

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of use of this Product Ruling

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

Potential participants may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Ginkgo Australia Project' or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Section 108-5 (ITAA 1997);
- Section 110-25 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and services tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the law

4. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.
5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this ruling, these persons are referred to as 'Growers'.
8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it. Growers who elect to market their own produce (see paragraphs 24 and 46) are excluded from the class of persons to whom this Ruling applies.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

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

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling as constituted by documents provided on 23 December 2003, 31 March 2004, 2, 7, 15, 22, 28 April 2004 and 6 May 2004 and additional correspondence dated 24 April 2004 and 3, 5, 6, 7, 12 May 2004;
- **Draft Prospectus/Product Disclosure Statement for Ginkgo Australia Project** prepared and issued by Natural Medicines of Australia Ltd, received on 2 April 2004;
- **Draft Lease and Management Agreement** between Natural Medicines Management Ltd ('Responsible Entity'), Natural Medicines of Australia Ltd ('Lessor') and the Grower, received on 2 April 2004;
- Draft Constitution of the Ginkgo Australia Project, dated 31 March 2004;
- Draft Compliance Plan for the Ginkgo Australia Project, received on 2 April 2004; and
- Draft Custodian Agreement for the Ginkgo Australia Project, received on 2 April 2004.

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

15. The documents highlighted are those that Growers may enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

17. The arrangement is called the Ginkgo Australia Project.

Location	Manjimup, Western Australia
Type of business each participant is carrying on	Commercial growing and cultivation of <i>Ginkgo biloba</i> trees for the purpose of harvesting Ginkgo leaves for Ginkgo Biloba Extract ('GBE').
Number of hectares to be under cultivation	100
Size of each Leased Area	0.1 hectares
Minimum subscription per Grower	1 Leased Area
Minimum subscription for the Project to proceed	250 Leased Areas (and 2,500,000 Shares in Natural Medicines of Australia Ltd. The purchase of shares is optional)
Number of trees per hectare	25,000
The term of the Project	15 years
Initial cost	\$2,750
Initial cost per hectare	\$27,500
Ongoing costs	Annual Management Fee; Annual Rent; Irrigation fee instalment for Year 1 and Year 2 of the Project; Trees fee for Year 1 of the Project; and Additional Insurance if required by the Grower.

18. The Ginkgo Australia Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity of the Project is Natural Medicines Management Ltd ('NMM').

19. Growers participating in the arrangement will enter into a Lease and Management Agreement ('LMA'). The Agreement provides for the lease of Land which is located in Manjimup, Western Australia and is described as Part of Nelson Locations 2256 and 3239 contained in Certificates of Title Volume 1216 Folio 747 and Volume 2051 Folio 290. Additional land within the Manjimup region is to be acquired by Natural Medicines of Australia Ltd ('NMA').

20. The Lease will give a Grower a lease over an identifiable area of land called a 'Leased Area' for a term being from the Commencement Date until the Project is terminated on 30 June 2019. Each Leased Area is 0.1 hectares and will be planted with 2,500 trees.

21. Overall, it is proposed to plant 100 hectares representing 1,000 Leased Areas. These Leased Areas will be separately identified in a plan of the Plantation. There is a minimum subscription of 250 Leased Areas and 2,500,000 Shares for the Project. Growers wishing to participate in the Project must apply by 15 June 2004.

22. NMA will be the owner of the Land and is planning to construct a processing facility on the Land for the production of Ginkgo Biloba Extract. Growers may subscribe for shares in NMA and applications may be made for an allocation of shares at a cost of \$0.50 cents each.

23. Growers will execute a power of attorney enabling the Responsible Entity, NMM, to act on their behalf as required, when they make an application for one or more Leased Areas.

24. Growers will enter into a contract with the Responsible Entity for the management of their Leased Area. The Responsible Entity will be responsible for establishing and cultivating the trees and harvesting the Produce of the Project. Growers may elect, prior to 1 January 2006, to take their Produce by giving written notice to the Responsible Entity and thereby become an Electing Grower (clause 18.1 of the LMA). The Lessor will purchase the Produce from the Non-Electing Growers at the prevailing market price (clauses 19.1 and 19.2 of the LMA).

Constitution

25. The Constitution establishes the Project and operates as a deed binding on all of the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which NMM agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

26. Under the terms of the Constitution, all moneys received from applications shall be paid to the Custodian. The Application Moneys will be released by the Custodian when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 11 of the Constitution). Pursuant to clause 20.1 of the Constitution, the Responsible Entity will keep a Register of Growers.

Compliance plan

27. As required by the Corporations Law, NMM has prepared a Compliance Plan. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and

responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease and Management Agreement

28. Growers participating in the arrangement will enter into a Lease and Management Agreement between NMM (the 'Responsible Entity'), NMA (the 'Lessor') and the Grower. NMM is a wholly owned subsidiary of NMA. Growers are granted an interest in land in the form of a lease to use their Leased Area for the purpose of conducting their business.

29. For Years 1 and 2 of the Project, each Grower must pay Annual Rent to the Lessor in an amount specified in Item 5 of the First Schedule to the Lease and Management Agreement on 31 October of the financial year to which it relates. From Year 3 to Year 15, Annual Rent will be payable on 15 June of the financial year to which it relates.

30. Some of the conditions of the lease are that the Grower:

- will not permit the Leased Area to be used for a purpose other than that of commercial horticulture;
- will not use, or permit to be used, the Leased Area for residential, recreational or tourist purposes; and
- must not erect any building or construction on the Leased Area, except with the approval of NMA and for the purpose of commercial horticulture.

31. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform management services under the agreement. Item 9 of the First Schedule to the Lease and Management Agreement specifies the services to be performed by the Responsible Entity. The Responsible Entity will supervise and manage all horticultural activities on behalf of the Grower.

32. During the period from Commencement Date to 30 June 2004 (Year 0) the Responsible Entity will supply the following services:

- engage NMA to obtain and commence sowing into the Nursery ginkgo seed suitable for the Project sufficient so as to be able to eventually transplant, allowing for attrition, a minimum of 2,500 Ginkgo Biloba plants to each Leased Area;
- obtain all relevant Government approvals for the Project;
- establish with consultants an integrated irrigation and drainage plan for the Project; engaging contractors to develop a soil plan and surveyors to develop contour maps;

- finalise and mark out the Ginkgo lot layout;
- develop a management plan for all Ginkgo lots in conjunction with the various Ginkgo purchasers;
- eradicate weeds, pest and vermin from the lot;
- prepare the individual lots;
- perform all administration and compliance duties; and
- manage the Project in accordance with good commercial horticulture practice.

33. The Responsible Entity will provide the following services during the period from 1 July 2004 to 30 June 2019:

- establish drainage on the Grower's Leased Area in accordance with the drainage plan;
- transplant *Ginkgo* seedlings from the Nursery in the winter of 2005 so as to establish 2,500 trees on each Leased Area;
- establish and maintain a suitable irrigation system to the Trees within the Leased Area;
- cultivate, tend, prune, fertilise, replant, spray, and otherwise care for the Trees;
- replace and plant any Trees that fail to establish or die within 12 months of being transplanted except for losses due to Force Majeure;
- keep access roads in good repair and the Leased Area free from vermin, noxious weeds, pests and disease;
- harvest and market the Produce grown on the Leased Area each year;
- establish and update a plan for management of the Plantation; and
- manage the Project in accordance with good commercial horticulture practice.

34. From the first year of harvest, the Responsible Entity will be entitled to a Bonus equal to 25% of the amount by which the Gross Sales Proceeds exceed the projected returns per Leased Area as set out in the Prospectus/Product Disclosure Statement (sub clause 22.1.3 of the LMA). Growers will share the Gross Sales Proceeds on a proportionate basis, following the payment of any Annual Contributions payable by the relevant Grower and the Responsible Entity's Bonus, if any (clause 20.3 of the LMA).

PR 2004/64**Fees**

35. The fees payable to the Responsible Entity under the Lease and Management Agreement on a per Leased Area basis are as follows:

Fee Type	Year 0 30/6/2004	Year 1 30/6/2005	Year 2 30/6/2006
Annual Management Fee	\$2,469.50	\$3,349.50	\$2,854.50
Irrigation	\$170.50	\$170.50	\$170.50
Trees	\$110.00	\$385.00	
Annual Rent		\$165.00	\$165.00

- Annual Management Fee of \$2,469.50 payable on Application for the period from the Commencement Date to 30 June 2004 (Year 0);
- Annual Management Fee of \$3,349.50 for managing and maintaining the Growers Leased Area for the 12 month period ending 30 June 2005 (Year 1), payable on 31 October 2004;
- Annual Management Fee of \$2,854.50 for managing and maintaining the Growers Leased Area for the 12 month period ending 30 June 2006 (Year 2), payable on 31 October 2005;
- The Annual Management Fee payable on 15 June of Year 3 will be \$1,320 and each year thereafter will be the amount of the fee in the prior year indexed at the annual rate of inflation. Fees will be payable on 15 June of the financial year to which the fee relates;
- An Irrigation fee is payable in 3 instalments of \$170.50 each, payable on Application, on 31 October 2004 for Year 1 and on 31 October 2005 for Year 2;
- A fee of \$110 is payable on Application and a further fee of \$385 is payable on 31 October 2004 for expenses associated with the cost of acquiring and establishing the Trees;
- Annual Rent of \$165 is payable on 31 October 2004 for Year 1 and 31 October 2005 for Year 2; and
- Annual Rent of \$165 is payable on 15 June 2006 for Year 3. For each subsequent financial year the Annual Rent will be fixed at \$165 but will be indexed at the annual rate of inflation and is payable on 15 June of the financial year to which the rent relates.

36. The Responsible Entity is also entitled to a Bonus that will be deducted from the Gross Sales Proceeds. The Bonus is calculated in accordance with the method described in paragraph 34 of this Ruling.

37. The Responsible Entity will use its best endeavours, if so requested, to arrange insurance on behalf of the Grower to cover against fire of the relevant Grower's Trees or proportional share of the Produce.

Planting

38. In autumn 2004, the Responsible Entity will arrange for the planting of seeds into a Nursery on the Plantation of sufficient quantity to enable planting of 2,500 seedlings per Leased Area. The Responsible Entity will transplant Ginkgo seedlings from the Nursery to the Grower's Leased Area in the winter of 2005 so as to establish 2,500 trees on the Leased Area. After that period, the Responsible Entity will maintain the trees in accordance with good horticultural practice and replant any trees that fail to establish or die within 12 months of being transplanted except for losses due to Force Majeure. The services to be provided by the Responsible Entity over the term of the Project are outlined in Item 9 of the First Schedule to the Lease and Management Agreement.

Harvesting

39. At all times the Grower has full right, title and interest in the Produce from the Leased Area and the right to have the Produce sold for their benefit (clause 9.3 of the LMA). The Ginkgo trees will remain the property of the Lessor. The Responsible Entity will harvest or arrange for some other person to harvest the Produce. The harvest shall take place in each year of the Term of the Project that there is a commercially harvestable crop, at such time or times as in the opinion of the Responsible Entity will maximise the price payable for the harvest.

40. The first commercial crop of Ginkgo leaves is expected during the income year ended 30 June 2007. Non-Electing Growers agree to sell the Ginkgo leaves from their harvests from Year 3 onward to the Lessor at a price equal to the prevailing market prices for mature Ginkgo leaves at the time of the harvest (clause 19.2 of the LMA). The Lessor and the Responsible Entity will appoint an independent marketing expert to assess the price payable for the harvest. The cost of transportation (if applicable) and of drying the leaves will be deducted from the price to be paid to the Grower.

41. The Gross Sales Proceeds from the pooled Produce of Non-Electing Growers will be paid direct to the Responsible Entity who must deposit the proceeds into a Produce Fund (clause 20 of the LMA). The Responsible Entity will deduct any Annual Contributions due and payable to itself, or the Lessor, under the Agreements, or in relation to the Responsible Entity's Bonus. The balance of the Net

Sales Proceeds will be distributed to the Non-Electing Growers on a Proportional Interest basis by 15 June in each year following harvest. The terms 'Produce Fund' and 'Proportional Interest' are defined in clause 1 of the Constitution.

42. As soon as practicable after the sale of the Produce from the Plantation each year, the Responsible Entity will ascertain the amount of the Responsible Entity's Bonus and will notify the Grower of any additional amount payable, or refund any excess amount to the Grower at the time of sending the notice.

Finance

43. Growers can fund their investment in the Project themselves or borrow from an independent lender.

44. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

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

Ruling

Application of this Ruling

45. This Ruling applies only to Growers who are accepted to participate in the Project:

- between 19 May 2004 and 1 June 2004; or
- during the period 2 June 2004 to 15 June 2004 (provided the Manager can wholly provide the services in consideration of the moneys payable on application, by 30 June 2004),

and who have executed a Lease and Management Agreement on or before 15 June 2004. A Grower's participation in the Project must constitute the carrying on of a business of primary production.

46. This Ruling does not apply to Growers who make an election under the Lease and Management Agreement to collect the Grower's Produce from the Growers' Leased Area.

Minimum subscription

47. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Prospectus/Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 250 Leased Areas and 2,500,000 Shares is reached.

The Simplified Tax System ('STS')

Division 328

48. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

49. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that

cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Assessable Income

Section 6-5 and section 328-105

50. That part of the gross sales proceeds from the Project attributable to the Grower's Produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

51. The Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

52. The Grower who is an 'STS taxpayer' recognises ordinary income from carrying on the business of horticulture at the time that income is received (paragraph 328-105(1)(a)).

Deductions for Annual Management Fees and Annual Rent

Section 8-1 and section 328-105

53. A Grower may claim on a per Leased Area basis, tax deductions for the revenue expenses in the Table below.

54. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Fee Type	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Annual Management Fee	\$2,469.50 See Notes (i) & (ii)	\$3,349.50 See Notes (i) & (ii)	\$2,854.50 See Notes (i) & (ii)
Annual Rent		\$165 See Notes (i) & (ii)	\$165 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. See example at paragraph 105.
- (ii) The Annual Management Fees and the Annual Rent shown in the Lease and Management Agreements are

deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (for example the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined in accordance with section 82KZMF (see paragraphs 80 to 87) unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Division 40

55. Growers will also be entitled to tax deductions relating to the establishment of horticultural plants (Ginkgo trees) and water facilities (irrigation). All deductions shown in the following Table are determined under Division 40.

Fee type	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Water facility (eg irrigation, dam, bore, etc)	\$170.50 See Notes (iii) & (iv)	\$170.50 See Notes (iii) & (iv)	\$170.50 See Notes (iii) & (iv)
Establishment of horticultural plants (Ginkgo trees)	Nil See Notes (iii) & (v)	Nil See Notes (iii) & (v)	Must be calculated See Notes (iii) & (v)

Notes:

- (iii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See example at paragraph 105.
- (iv) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is

incurred and one third in each of the next 2 years of income (section 40-540).

The deductions shown in the Table above indicate the amounts are deductible under Subdivision 40-F. However, an **STS taxpayer** can choose to deduct amounts under Subdivision 328-D. Under Subdivision 328-D, the deduction must be calculated and the expenditure must be incurred on 'depreciating assets'. In addition, the Grower must be an STS taxpayer for the income year in which he or she starts to 'hold' the asset and the income year in which he or she first uses the asset or has it 'installed ready for use' to produce assessable income.

- (v) Ginkgo trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value.

The deduction for the Ginkgo trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment.

If the Ginkgo trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the Ginkgo trees enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the Ginkgo trees enter their first commercial season.

Interest

56. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 80 to 87 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Shares

57. The shares in NMA are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

58. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

Dividends relating to the shares

59. Dividends paid out of profits by NMA are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

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

Section 35-55 – Exercise of Commissioner’s discretion

60. A Grower who is an individual accepted into the Project by 15 June 2004 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2004 to 30 June 2006**. This conditional exercise of the discretion will allow those losses to be offset against the Grower’s other assessable income in the income year in which the losses arise.

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

61. For a Grower who participates in the Project and incurs expenditure as required by the Lease and Management 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 – 82KZMF (but see paragraphs 80 to 95);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanation

Is the Grower carrying on a business?

62. For the amounts set out in the Tables above to constitute allowable deductions, the Grower’s horticulture activities as a participant in the Ginkgo Australia Project, must amount to the

carrying on of a business of primary production. These horticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

63. For schemes such as the Ginkgo Australia Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

64. Generally, a Grower will be carrying on a business of horticulture where:

- the Grower has an identifiable interest (by lease) in the land on which the Grower's Ginkgo trees are established;
- the Grower has a right to harvest and sell the Ginkgo leaves each year from those trees;
- the horticultural activities are carried out on the Grower's behalf;
- the horticultural activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

65. In this Project, each Grower enters into a Lease and Management Agreement. Under the Lease and Management Agreement, each individual Grower will have rights over a specific and identifiable area of land. The Lease and Management Agreement provides the Grower with an ongoing interest in the specific Ginkgo trees on the leased area for the term of the Project. Under the Lease, the Grower must use the land in question for the purpose of carrying out horticultural activities and for no other purpose. The Lease allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

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

67. In establishing the horticultural business, the Grower engages the Manager to purchase and install water facilities (for example irrigation) and to acquire and plant *Ginkgo biloba* trees on the Grower's leased area. During the term of the Project, these assets will be used wholly to carry out the Grower's horticultural activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the Ginkgo leaves grown on the Grower's leased area.

68. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

69. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of their Ginkgo leaves that will return a before-tax profit, that is a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

70. The pooling of Ginkgo leaves grown on the Grower's Leased Area with the Ginkgo leaves of other Growers is consistent with general horticultural practices. Each Grower's proportionate share of the sale proceeds of the pooled Ginkgo leaves will reflect the proportion of the Ginkgo leaves contributed from their Leased Area.

71. The Manager's services and the installation of assets on the Grower's behalf are also consistent with general horticultural practices. The assets are of the type ordinarily used in carrying on a business of horticulture. While the size of a leased area is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

73. The horticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' horticulture activities in the Ginkgo Australia Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

74. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

75. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Annual Management Fees and Annual Rent

Section 8-1

76. Consideration of whether the Annual Management Fees and Annual Rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

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

Interest deductibility

Section 8-1

78. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

79. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 80 to 87).

Prepayment provisions

Sections 82KZL to 82KZMF

80. 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 (eg. the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

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

Sections 82KZME and 82KZMF

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

83. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and

- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

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

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

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

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

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

Application of the prepayment provisions to this Project

88. In this Project, an initial Annual Management Fee of \$2,469.50 per Leased Area will be incurred on execution of the Lease and Management Agreement. The Annual Management Fee is charged for providing management services to a Grower by 30 June of the year of execution of the Agreements. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

89. In particular, the management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

90. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Lease and Management Agreement, Annual Rent is payable annually in advance for the lease of the land during the expenditure year.

91. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 35, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

92. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

*Growers who **choose** to pay fees for a period in excess of that required by the Project's agreements*

93. Although not required under the Lease and Management Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 91, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

94. For these Growers, the amount and timing of deductions for any relevant prepaid Annual Management Fees, prepaid Annual Rent, or prepaid interest will depend upon when the respective

amounts are incurred and what the 'eligible service period' is in relation to these amounts.

95. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Expenditure of a capital nature

Division 40 and Division 328

96. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to water facilities and the establishment of the Ginkgo trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

97. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

98. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 55 in the Table and the accompanying Notes.

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

Section 35-55 – Exercise of Commissioner's discretion

99. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2004 to 30 June 2006** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14, *Income tax: Division 35 – non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2004 up to and including 30 June 2006:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the horticulture industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

100. 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

101. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

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

103. The Ginkgo Australia 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 54 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.

104. 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 their Ginkgo leaves. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

105. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2003 Susan receives a valid tax invoice from her manager requesting payment of a management

fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 2004, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

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

Detailed contents list

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Commissioner of Taxation

19 May 2004

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	- schemes and shams
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TR 92/1; TR 92/20; TR 97/11;	- tax benefits under tax avoidance schemes
TR 97/16; TR 98/22; TR 2000/8;	- tax shelters
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<i>Subject references:</i>	<i>Legislative references:</i>
- carrying on a business	- ITAA 1936
- commencement of business	- ITAA 1936 44
- fee expenses	- ITAA 1936 44(1)
- horticulture	- ITAA 1936 82KL
- irrigation expenses	- ITAA 1936 82KL(1)
- management fees expenses	- ITAA 1936 82KZL
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- primary production	- ITAA 1936 82KZME
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- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt III Div 3 Subdiv H
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- ITAA 1936 177A
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- ITAA 1997 6-5
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- ITAA 1997 Div 27
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- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40F
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530 item 2
- ITAA 1997 40-535
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- ITAA 1997 110-5
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 Subdiv 328-D
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- TAA 1953 Pt IVAAA
- Copyright Act 1968
- Corporations Act 2001

Case references:

- *Commissioner of Taxation v. Lau*
(1984) 6 FCR 202; 84 ATC 4929;
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