

PR 2004/75 - Income tax: New World 2020 Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *28 June 2006*



Product Ruling

Income tax: New World 2020 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.*

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

No guarantee of commercial success

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.

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 the 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.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'New World 2020 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 70 (ITAA 1997);
- Division 328 (ITAA 1997);
- Division 328 to the *Income Tax (Transitional Provisions) Act 1997*;
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Sections 82KZME - 82KZMF (ITAA 1936);
- Section 82KZMG (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Member') 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. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. 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 potential 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 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 (i.e. being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Members'.

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. Members who elect to market their own produce (see paragraphs 47 and 56) are also excluded from the class of persons to whom this Ruling applies. Also, the class of persons will not include any Members that do not pay the full amount of Application Price payable under the Project Management Agreement and the Sub-lease Agreement on or before 30 June 2004 for 2004 Members and 30 June 2005 for 2005 Members.

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 9 June 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 the private ruling if the income year to which the private ruling 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).

Note: The Addendum to this Ruling that issued on 28 June 2006, applies on and from 1 July 2005.

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 persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 18 August 2003;
- **Draft Product Disclosure Statement for the New World 2020 Project prepared and issued by Huntley Management Limited (Huntley), received 25 May 2004;**
- **Constitution of the New World 2020 Project, received 25 May 2004;**
- **Draft Project Management Agreement between Huntley Management Limited (the 'Responsible Entity'), New World Management Pty Ltd (the 'Manager') and each Member, received 25 May 2004;**
- **Draft Sub-lease between each Member and New World Management Pty Ltd, received 25 May 2004;**
- Head Lease Part Alice Station between New World Capital Limited (the 'Landowner') and New World Management Pty Ltd (the Head Lessee), received 25 May 2004;
- Custody Agreement between Huntley Custodians Limited ('Custodian') and Huntley Management Limited (the 'Client'), dated 30 May 2004;
- Draft Compliance Plan for the New World 2020 Project, received 25 May 2004;
- Independent Cropping Report, dated 25 May 2004;
- Independent Forester's Reports, dated 30 May 2002;
- Director's Undertaking, dated 18 September 2003; and
- Additional correspondence between the Tax Office and the Applicant dated 17 September 2003, 24 October 2003, 31 October 2003, 3 December 2003, 5 December 2003, 8 December 2003, 9 December 2003, 11 March 2004, 13 April 2004, 25 May 2004, 27 May 2004, 31 May 2004, 1 June 2004 and 2 June 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 Members may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Member, or any associate of a Member, will be a party to, which are a part of the arrangement.

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

Overview

17. The salient features of the New World 2020 Project are as follows:

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| Location | The north-eastern region of New South Wales. |
| Type of business each participant is carrying on | Commercial growing and cultivation of: <ul style="list-style-type: none"> • Hardwood trees for the purpose of harvesting and selling timber; and • Up to two annual crops for the purpose of production and sale. |
| Number of hectares offered for cultivation | Approximately 175 hectares for Crop Lots and 65 hectares for Forest Lots initially but additional land may be acquired. |
| Size of each interest (Unit) | $\frac{5}{6}$ hectare comprising $\frac{1}{2}$ hectare for Hardwood trees (Forest Lot) and $\frac{1}{3}$ hectare for cropping (Crop Lot). |
| Number of trees established per hectare | 1,000 Hardwood trees planted, guaranteed survival rate of 90%. |
| The term of the Project | Approximately 20 years. |
| Initial cost | \$4,620 |
| Initial cost per hectare | \$5,544 |
| Ongoing and other costs | Rent and Management fees. Variable costs charged on a recovery basis. Harvesting and marketing fees. Success Fee. |

18. The Project will be registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is Huntley Management Limited. The Manager is New World Management Pty Ltd ('the Manager'). The Project will be conducted on land in north-eastern New South Wales. The Project will initially commence on land known as 'Alice Station' and 'Rangeview' being:

- Lot 1 in Deposited Plan 130830, Shire of Copmanhurst, Parish of Alice, County of Drake;
- Lot 77 in Deposited Plan 752364 Shire of Copmanhurst, Parish of Alice, County of Drake;
- Lot 74 in Deposited Plan 752376 Shire of Copmanhurst, Parish of Ewingar, County of Drake; and
- Lots 19 and 94 in Deposited Plan 751059 at Woodenbong in the Shire of Kyogle, Parish of Donaldson and County of Buller.

19. The Project Management Agreement provides for an area of land called a 'Unit' to be sub-let to the Member for a term of approximately 20 years. Each Unit is approximately $\frac{5}{6}$ hectare and is comprised of a Forest Lot of $\frac{1}{2}$ hectare for the production of Hardwood trees and a Crop Lot of $\frac{1}{3}$ hectare for the production of annual crops.

20. The Member's Forest Lot and Crop Lot will be on different locations on the properties used for the Project. Approximately 175 hectares, representing 525 Crop Lots, are available at Alice Station and 65 hectares, representing 160 Forest Lots, are available at Rangeview under this offer. Additional land may be acquired for the Project. All Project land will be assessed by an independent expert as suitable for the purposes of the Project.

21. Under this offer, Members may enter the Project in consecutive financial years. However, this Ruling will be restricted to participants entering the Project in either the 2003/2004 income year (defined for the purposes of this Ruling as '2004 Members') or the 2004/2005 income year (defined for the purposes of this Ruling as '2005 Members').

22. Members enter into a contract with the Responsible Entity for the management of their Unit. The Responsible Entity will be responsible for establishing and cultivating the trees and the crop and the harvesting, processing and sale of the produce. Members may elect to harvest and sell their own produce or the Manager will do so on their behalf.

23. The Crop will be an annual crop and harvesting will take place each year.

24. Tree thinning will commence after approximately 4 years. A further thinning after 9 years is expected to produce a small commercial quantity of wood produce. The remaining trees will be harvested towards the end of the Project and processed to rough sawn timber lengths.

25. Upon application, Members will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required.

Constitution

26. The Constitution establishes the Project and operates as a deed binding on all of the Members and the Responsible Entity. The Constitution sets out the terms and conditions under which Huntley Management Limited agrees to act as the Responsible Entity and manage the Project. A Project Management Agreement and a Sub-lease Agreement, defined as 'Project Management Agreement', will be executed on behalf of a Member following the acceptance of their signed Application Form from the Product Disclosure Document. Members are bound by the Constitution by virtue of their participation in the Project.

27. The Responsible Entity will:

- prepare and procure the execution of a Project Management Agreement after acceptance of an application (clause 6);
- maintain a register of Members (clause 27); and
- distribute profits (clause 30).

28. Under the terms of the Constitution, all moneys received from applications shall be deposited into an Application Fund. The Application Moneys will be released when the Responsible Entity is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 7 and 8 of the Constitution).

Acceptance of Applications

29. The Member's participation in the Project commences on the date the Project Management Agreement and the Sub-lease Agreement are executed and a Unit(s) is allocated to the Member. The Agreements may be executed following the acceptance of a Member's Application for a Unit(s). The Responsible Entity will not accept a Member's Application for a Unit(s) unless, amongst other things, the Unit(s) is available to be allocated.

Compliance Plan

30. Huntley Management Limited has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity meets its obligations and responsibilities contained in the Constitution and that the interests of Members are protected.

Sub-lease

31. The owner of the land, New World Capital Ltd, has agreed to lease an area of land to the Manager, New World Management Pty Ltd, in order to conduct the Project. The Manager is entitled to use the land for the purposes of the Project and to sub-lease the land to Members.

32. Members participating in the arrangement will enter into a Sub-lease Agreement with the Manager. Members are granted an interest in land in the form of a sub-lease to use their leased area, comprising one or more Units, for the purpose of cultivating and harvesting Hardwood trees and an annual crop. All Timber Produce and Crop Produce from the Unit(s) will be the property of the Member.

33. The term of the agreement is approximately 20 years, with termination occurring when the final distribution of the sales proceeds is made to the Member or earlier pursuant to the provisions of the Agreement (Clauses 4.1, 4.8, 4.9 and 4.10).

34. Each Member must pay Rent to the Manager during the term of the Project in an amount specified at Item 2 of Schedule 1 to the Sub-lease Agreement.

Project Management Agreement

35. The Project Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between the Responsible Entity, the Manager and the Member. Under the Agreement the Member appoints the Responsible Entity to establish, maintain and manage the Member's Unit(s) and be responsible for the harvesting, processing and sale of the Timber Produce and the Crop Produce from the Member's Unit(s).

36. The Agreement commences on the date of execution of the Project Management Agreement.

37. Pursuant to the terms of the Project Management Agreement, the Responsible Entity appoints the Manager to perform services specified in the agreement (clause 4.1). The services are specified in Schedule 1 of the Project Management Agreement and include, but are not limited to, the provision of the following:

Initial Services – Forest Lots

- procure seedlings;
- tend tree seedlings as required in respect of planting on the Member's Forest Lots;
- take all necessary steps to control weeds and vermin on the Member's Forest Lots in respect of planting and establishing trees;

- rip and mound the Member's Forest Lots;
- apply fertilisers as required in respect of planting on the Member's Forest Lots; and
- plant the tree seedlings.

Initial Services – Crop Lots

- procure seed for cropping on the Member's Crop Lots;
- take all necessary steps to control weeds and vermin prior to establishing crops;
- plough and scarify the Member's Crop Lots as required prior to sowing;
- apply fertilisers as required in respect of planting on the Member's Crop Lots; and
- sow the seeds.

Ongoing Services

- manage the Forest Lots and Crop Lots and employ appropriate personnel for that purpose;
- use all reasonable measures to exterminate and keep the Lots free from rabbits, vermin and other pests;
- monitor nutrient status and recommend appropriate schedule of fertiliser and trace elements for the Forest Lots and Crop Lots;
- supervise livestock grazing (if any);
- control weeds in accordance with good tree cropping and farming practices as appropriate;
- maintain access roads and firebreaks;
- monitor markets for plantation grown timber of the species planted in the timber Plantations and for crops grown in the crop Plantations;
- liaise with purchasers of timber and (as appropriate) processors and operators of port facilities as to access to markets; and
- liaise with purchasers of crop produce as appropriate to secure sales of that produce.

Pruning Services

- approximately 4 years after the Commencement Date the Responsible Entity will inspect the Member's Forest Lots and if required, prune the Tree Crop.

Harvesting and Marketing Services

- plant, manage, harvest and market a Crop on an annual basis or as required;
- arrange thinning of the Member's Tree Crop, where required;
- arrange the Clear Felling of the Member's Tree Crop; and
- arrange the sale of the Timber Produce.

Fees

38. Fees are payable under the Project Management Agreement and the Sub-Lease on a per Unit basis. The total of the fees payable on Application is \$4,620 represented as:

- Initial Services Fee of \$3,718 for the Forest Lot payable for Initial Services to be performed during the Initial Period, being the 12 month period from and including the Commencement Date; and
- Initial Services Fee of \$902 for the Crop Lot payable for Initial Services to be performed during the Initial Period.

39. Amounts payable in subsequent years are as follows:

- Management Fee of \$170.61 for the Forest Lot and \$170.61 for the Crop Lot per annum (CPI indexed) payable in advance on or before 30 June of each year after the Initial Period;
- Rent of \$142.17 per annum for the Forest Lot and \$142.17 per annum for the Crop Lot (CPI indexed) payable in arrears on or before 30 June of each year after the Initial Period;
- Variable costs in relation to Forest Lot for insurance, fertilising, weed and pest control, thinning, pruning and other forestry costs payable in arrears on or before 30 June each year after the Initial Period;
- Variable costs in relation to Crop Lot for insurance, fertilising, sowing, harvesting, weed and pest control and all other related cropping costs payable in arrears on or before 30 June each year after the Initial Period;

40. The Member is also required to pay the following amounts that will be deducted from the sales proceeds:

- an amount equal to 3.3% of the Net Sales Proceeds before Management Fees for each Unit in consideration for providing the Harvesting and Marketing Services (clause 7.3 and Item 3 of Schedule 2);
- with respect to the Forest Lot, a Success Fee equal to 55% of the amount by which the actual Net Sales Proceeds \$32,000 (clause 7.4 and Item 4 of Schedule 2); and
- with respect to the Crop Lot, a Success Fee equal to 55% of the excess over \$300 of the amount by which the Crop income exceeds the costs associated with both the Forest and the Crop (clause 7.4 and Item 4 of Schedule 2).

41. The Manager will maintain a public risk insurance policy in respect of the Plantation and such additional insurance, including fire insurance, as in the opinion of the Responsible Entity is warranted and readily available at a reasonable cost. The Member will bear the cost of such insurance (sub-clause 5.9(b) of the Project Management Agreement).

Planting

42. Under the Project Management Agreement, the Manager will supply the necessary seedlings for the Forest Lots and seed for the Crop Lots. The Manager will be responsible for planting the seedlings and sowing the seed on the Lots.

43. Each Forest Lot will be planted with a minimum of 500 Hardwood seedlings. The species to be planted will vary according to an assessment of each site based on soil types, aspect, topography and climate. The species recommended by the Manager are:

- On well drained areas that are not subject to heavy frosting, *Corymbia citriodora* sub spp. *variegata* (Spotted gum);
- On well drained areas that are not subject to heavy frosting, however have a harsher aspect and may be subject to periodic droughts, *E.cloeiziana* (Gympie messmate);
- On well drained areas that may also be subject to frosting, *E. dunnii* (Dunn's White gum);
- On areas of impeded drainage that may also be subject to heavy frosting a hybrid *Corymbia citriodora* sub spp. *variegata* (Spotted gum) and *E. torelliana* (Cadaghi); and

- On areas of poor drainage that may also be subject to heavy frosting, E. moluccana (Grey box).

44. The Responsible Entity will conduct a survival count of seedlings 12 months after planting. The Responsible Entity covenants to replace seedlings on a Forest Lot which have died to achieve a maximum of 90% of the initial stocking rate as soon as practicable thereafter and at its own cost.

45. The Product Disclosure Statement states that the Manager will not limit the type of Crop that will be grown to a specific type and will research and monitor prevailing conditions in an effort to select crops that will give benefits to Members.

46. The Crops initially selected are the Adzuki bean, Barley and Maize. Adzuki beans are sown in January and harvested approximately 100 days later in April. Barley will be planted as a winter crop. Maize will be planted every fourth summer as a rotational crop.

Harvesting and Sale

47. Upon Application, Members may elect to be a 'Non-participating Member' and personally market the produce grown on their Lots (clauses 10.1 and 10.11). This Ruling does not apply to Members who make such an election.

48. The Responsible Entity will sell the timber and crop produce harvested on behalf of the Members who do not make such an election ('Participating Members') by entering into an agreement that is in the best interests of the Member (clauses 10.4 and 10.14).

49. The harvest of the Forest Lots will take place at an appropriate time determined by the Responsible Entity but is expected to take place in the final year of the Project. Crops will be harvested annually, with the first Adzuki bean harvest occurring in June 2004.

50. The Gross Sales Proceeds from the produce of Participating Members will be paid direct to the Responsible Entity. The Responsible Entity is authorised to retain the costs, indemnities, Management Fees and Rent as set out in clauses 10.9 and 10.19 of the Project Management Agreement. Participating Members will share the Net Sales Proceeds according to their Proportional Interest in the Project. The term 'Proportional Interest' is defined in clause 1 of the Project Management Agreement.

Finance

51. Members can fund their investment in the Project themselves, or borrow from an independent lender.

52. The Project documents allow for Applications to be accepted and Allotment of Unit(s) to occur where Members do not pay the Application Price in full on Application as they are waiting for finance to be finalised. Members accepted in these circumstances can not rely on this Product Ruling where the full Application Price is not paid by 30 June 2004 for 2004 Members and 30 June 2005 for 2005 Members.

53. Where an application is accepted subject to finance approval by any lending institution, Members cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 30 June 2004 for 2004 Members and 30 June 2005 for 2005 Members.

54. This Ruling does not apply if the finance arrangement entered into by the Member 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 Members for the Project.

Ruling

Application of this Ruling

55. This Ruling applies only to Members who are accepted to participate in the Project:

- on or before 30 June 2004 where the Member has executed a Project Management Agreement on or before that date (2004 Members); and/or
- on or after 1 July 2004 and on or before 30 June 2005, where the Member has executed a Project Management Agreement on or between those dates (2005 Members).

The Member's participation in the Project must constitute the carrying on of a business of primary production. This Ruling does not apply to Non-participating Members who elect to personally market produce produced from their Unit(s).

56. A Member is not eligible to claim any tax deductions until the Member's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to:

- Members who make an election to collect the Member's Produce from the Member's Unit(s); or
- 2004 Members who have not paid full subscription monies by 30 June 2004 and 2005 Members who have not paid full subscription monies by 30 June 2005.

The Simplified Tax System ('STS')

Division 328

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

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

57A. Changes to the STS rules apply from 1 July 2005. From that date, 'STS taxpayers' may use the accruals accounting method. For a Member participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Member who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see section 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

Qualification

58. This Product Ruling assumes that a Member who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Member may become an 'STS taxpayer' at a later point in time. Also, a Member 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 Members that cannot be accommodated in this Ruling. Such Members can ask for a private ruling on how the taxation legislation applies to them.

Prepaid expenditure for Initial Services Fees and Management Fees***Sections 82KZME and 82KZMF***

59. The following expenditure incurred by a Member who is accepted into this Project is subject to the prepayment rules in sections 82KZME and 82KZMF:

- \$902 for that part of the Initial Services Fee for Initial Services to be provided in respect to the Crop Lot during the Initial Period;
- \$170.61 being the annual Management Fees in respect to the Forest Lot and the Crop Lot for Year 2;
- \$170.61 being the annual Management Fees in respect to the Crop Lot for Year 2; and
- the Management Fees in respect to the Forest Lot and the Crop Lot for Year 3.

60. In this context, a prepayment refers to advance expenditure incurred by a Member in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Member prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Member must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Notes (iii), (iv) and (v) in the table at paragraph 74).

61. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Member can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

62. Sections 82KZME and 82KZMF are discussed in greater detail below at paragraphs 99 to 106.

Prepaid expenditure for 'seasonally dependent agronomic activities'

Section 82KZMG

63. Where certain advance expenditure, and the agreement under which that expenditure is incurred, meets the requirements of section 82KZMG, the formula in subsection 82KZMF(1) will not operate to determine the timing of the deduction allowable. The requirements of section 82KZMG are set out below in paragraphs 107 to 111.

64. Among other things, expenditure that complies with section 82KZMG must be for 'seasonally dependent agronomic activities' that are carried out by the manager during the Project's 'establishment period'. The 'eligible service period' relating to this expenditure must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year.

65. Under the Project Management Agreement, for each Forest Lot, a Member incurs \$3,718 for 'seasonally dependent agronomic activities'. This expenditure is deductible in the income year that the Member incurs this amount.

Assessable Income

Section 6-5 and section 328-105

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

67. The Member who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of agriculture at the time that income is derived.

68. For the 2005 and prior income years, a Member who is an 'STS taxpayer' recognises ordinary income from carrying on the business of agriculture at the time the income is received (paragraph 328-105(1)(a)). For the 2005-06 and later income years, a Member who is an 'STS taxpayer' using the accruals accounting method will be assessable on this income in the income year in which the income is derived and a Member who is an 'STS taxpayer' using the cash accounting method will be assessable on this income in the income year in which the income is received.

Treatment of trading stock**Section 70-35**

69. A Member who is not an 'STS taxpayer' may, in some years, hold Crop Produce that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Member must include the amount of that excess in assessable income.

70. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Member may claim the amount of that excess as an allowable deduction.

Section 328-285

71. A Member who is an 'STS taxpayer' may, in some years, hold Crop Produce that will constitute trading stock on hand. Where, for such a Member, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

72. Alternatively, a Member who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Initial Services Fees, Management Fees, Rent and Variable Costs**Section 8-1 and section 328-105**

73. A Member may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table(s).

74. However, if for any reason, an amount shown or referred to in the Tables below is not fully paid in the year in which is incurred by a Member who is an 'STS taxpayer' for the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years, then the amount is only deductible to the extent to which it has been paid, or has been paid for the Member. Any amount or part of an amount shown in the Tables 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.

2004 Members

| Fee Type | ITAA 1997 Section | Year ended 30/06/2004 | Year ended 30/06/2005 | Year ended 30/06/2006 |
|---|----------------------------------|---|--|--|
| Initial Services Fee – Forest Lot | 8-1 | \$3,718 See Notes (i) & (ii) | | |
| Initial Services Fee – Crop Lot | 8-1 | Amount must be calculated – See Notes (i), (iii) and (iv) | | |
| Management Fees – Forest Lot | 8-1 | | Amount must be calculated – See Notes (i), (iii) and (v) | Amount must be calculated – See Notes (i), (iii) and (v) |
| Management Fees – Crop Lot | 8-1 | | Amount must be calculated – See Notes (i), (iii) and (v) | Amount must be calculated – See Notes (i), (iii) and (v) |
| Rent – Forest Lot | 8-1 | | \$142.17 – See Notes (i) and (vi) | \$142.17 (indexed) – See Notes (i) and (vi) |
| Rent – Crop Lot | 8-1 | | \$142.17 – See Notes (i) and (vi) below | \$142.17 (indexed) – See Notes (i) and (vi) |
| Variable Costs (to be advised by Manager) | 8-1 | | Amount must be calculated – See Notes (i) and (vi) | Amount must be calculated – See Notes (i) and (vi) |

2005 Members

| Fee Type | ITAA 1997 Section | Year ended 30/06/2005 | Year ended 30/06/2006 | Year ended 30/06/2007 |
|--|----------------------------------|--|---|---|
| Initial Services Fee – Forest Lot | 8-1 | \$3,718 See Notes (i) & (ii) | | |
| Initial Services Fee – Crop Lot | 8-1 | Amount must be calculated – See Notes (i), (iii) and (iv) | | |
| Management Fees – Forest Lot | 8-1 | | Amount must be calculated – See Notes (i), (iii) and (v) | Amount must be calculated – See Notes (i), (iii) and (v) |
| Management Fees – Crop Lot | 8-1 | | Amount must be calculated – See Notes (i), (iii) and (v) | Amount must be calculated – See Notes (i), (iii) and (v) |
| Rent – Forest Lot | 8-1 | | \$142.17 – See Notes (i) and (vi) | \$142.17 (indexed) – See Notes (i) and (vi) |
| Rent – Crop Lot | 8-1 | | \$142.17 – See Notes (i) and (vi) | \$142.17 (indexed) – See Notes (i) and (vi) |
| Variable Costs (to be advised by Manager) | 8-1 | | Amount must be calculated – See Notes (i) and (vi) | Amount must be calculated – See Notes (i) and (vi) |

Notes:

- (i) If the Member 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 1 at paragraph 145;
- (ii) The Initial Services Fee – Forest Lot is expenditure for ‘seasonally dependent agronomic activities’ (see paragraphs 107 to 111) and is deductible in the income year in which it is incurred (where the Member is not an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the accruals accounting method for the 2006 and later income years) or the year in which it is paid (where the Member is an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the cash accounting method for the 2006 and later income years);
- (iii) Although the Project Management Agreement requires the Initial Management Fee – Crop Lot, Management Fees – Forest Lot and the Management Fees – Crop Lot to be prepaid, for a Member who acquires the minimum allocation of 1 Unit, the amount of the prepaid Initial Services Fee – Crop Lot and Management Fees in respect to the Forest Lot and the Crop Lot are less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 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 (where the Member is not an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the accruals accounting method for the 2006 and later income years) or the year in which it is paid (where the Member is an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the cash accounting method for the 2006 and later income years). (See Example 2 at paragraph 146);
- (iv) Where a Member acquires more than 1 Unit, the amount of the Member’s prepaid Initial Services Fee – Crop Lot will be more than \$1,000. The Initial Services Fee – Crop Lot is **NOT** deductible in full in the year in which it is incurred (where the Member is not an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the accruals accounting method for the 2006 and later income years) or the year in which it is paid (where the Member is an ‘STS taxpayer’ in the 2005 and prior income years or is an ‘STS taxpayer’ using the cash accounting method for the 2006 and later income years). The deduction for the Initial Services Fee – Crop Lot must be determined using the formula in subsection 82KZMF(1) (see

paragraph 61 of this Ruling). The Responsible Entity will inform Members of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 3 at paragraph 147);

- (v) Where a Member acquires more than 5 Units, the amount of the Member's prepaid Management Fees – Forest Lot and prepaid Management Fees – Crop Lot will be more than \$1,000. The Management Fees in respect to the Forest Lot and the Crop Lot are **NOT** deductible in full in the year in which they are incurred (where the Member is not an 'STS taxpayer' in the 2005 and prior income years or is an 'STS taxpayer' using the accruals accounting method for the 2006 and later income years) or the year in which they are paid (where the Member is an 'STS taxpayer' in the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years). Such Members **MUST** determine the deduction for the prepaid Management Fees using the formula in subsection 82KZMF(1) (see paragraph 61 of this Ruling); or
- (vi) Where a Member pays the Rent and the Variable Costs in the relevant income years shown in the Project Management Agreement, those fees are deductible in full in the year that they are incurred (where the Member is not an 'STS taxpayer' in the 2005 and prior income years or is an 'STS taxpayer' using the accruals accounting method for the 2006 and later income years) or the year in which they are paid (where the Member is an 'STS taxpayer' in the 2005 and prior income years or is an 'STS taxpayer' using the cash accounting method for the 2006 and later income years). However, if a Member **chooses** to prepay fees for the doing of a thing (for example, the provision of 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 using the formula shown in paragraph 61 of this Ruling unless the expenditure is 'excluded expenditure'.

Interest

75. The deductibility or otherwise of interest incurred by Members 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 Members who borrow funds in order to participate in the

Project, should read the discussion of the prepayment rules in paragraphs 99 to 106 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 Member's choice.

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

Section 35-55 – Commissioner's discretion

76. For a Member who is an individual and who enters the Project during the year ended 30 June 2004 or 30 June 2005 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. The Member's forestry activity and cropping activity will be treated as separate business activities for the purposes of applying the Commissioner's Discretion under paragraph 35-55(1)(b). Under paragraph 35-55(1)(b) the Commissioner will decide:

- in relation to the forestry activity, for the income years ending:
 - 30 June 2004 to 30 June 2023 for 2004 Members; and
 - 30 June 2005 to 30 June 2023 for 2005 Members;
- in relation to the cropping activity, for the income years ending:
 - 30 June 2004 for 2004 Members; and
 - 30 June 2005 for 2005 Members;

that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

77. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the 'exception' in subsection 35-10(4) applies (see paragraph 128 in the Explanations part of this ruling, below);
- a Member's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Member's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

78. Where, the 'exception' in subsection 35-10(4) applies, the Member's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This

means that a Member will not be required to defer any deductions attributable to their business activity in excess of any assessable income from that activity, i.e. any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

79. Members are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Members should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Section 82KL and Part IVA

80. For a Member who participates in the Project and incurs expenditure as required by the Project Management Agreement and the Sub-lease Agreement the following provisions of the ITAA 1936 have application as indicated:

- 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 Member carrying on a business?

81. For the amounts set out in the Tables above to constitute allowable deductions the Member's forestry and cropping activities as a participant in the New World 2020 Project must amount to the carrying on of a business of primary production.

82. Where there is a business, or a future business, the gross proceeds from the sale of the Forest Produce and the Crop Produce will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

83. For schemes such as that of the New World 2020 Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Member'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.

84. Generally, a Member will be carrying on a business of forestry and cropping, and hence primary production, if:

- the Member has an identifiable interest (by lease or by licence) in the land on which the Member's trees and crops are established;
- the Member has a right to harvest and sell the Timber Produce and Crop Produce from those trees and crops;
- the forestry activities and cropping activities are carried out on the Member's behalf;
- the forestry activities and cropping activities of the Member are typical of those associated with a forestry business and a cropping business; and
- the weight and influence of general indicators point to the carrying on of a business.

85. In this Project, each Member enters into a Project Management Agreement and a Sub-lease Agreement.

86. Under the Sub-lease Agreement each individual Member will have rights over a specific and identifiable area of $\frac{5}{6}$ hectare of land, comprising of $\frac{1}{2}$ hectare for Hardwood trees (Forest Lot) and $\frac{1}{3}$ hectare for cropping (Crop Lot). The Sub-lease Agreement provides the Member with an ongoing interest in the specific trees and crops on the sub-leased areas for the term of the Project. Under the sub-lease the Member must use the land on which the Forest Lot and the Crop Lot are located for the purpose of carrying out forestry activities and cropping activities, and for no other purpose. The sub-lease allows the Responsible Entity to come onto the land to carry out its obligations under the Project Management Agreement.

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

88. The Responsible Entity is also engaged to harvest and sell, on the Member's behalf, the Crop Produce grown on the Member's Crop Lot.

89. 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.

90. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Member in the Project will derive assessable income from the sale of the Crop Produce 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.

91. The pooling of Timber Produce and Crop Produce from trees grown on the Member's Forest Lot and crops grown on the Member's Crop Lot with the Timber Produce and Crop Produce of other Members is consistent with general forestry and cropping practices. Each Member's proportionate share of the sale proceeds of the pooled Timber Produce and Crop Produce will reflect the proportion of the trees and crops contributed from their Forest Lot and Crop Lot.

92. The Responsible Entity's services are also consistent with general forestry and cropping practices. They are of the type ordinarily found in forestry and cropping ventures that would commonly be said to be businesses. While the size of a Forest Lot and Crop Lot is relatively small, they are of a size and scale to allow them to be commercially viable. (see Taxation Ruling IT 360).

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

94. The forestry activities and cropping 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 Members' forestry activities and cropping activities in the New World 2020 Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

96. The question of whether a Member is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Member 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 the Initial Services Fees, Management fees, Rent and Variable Costs

Section 8-1

97. Consideration of whether the initial management fees, ongoing management fees and lease fees 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.

98. The Initial Services Fees, Management Fees, Rent and Variable Costs associated with the forestry activities and cropping activities will relate to the gaining of income from the Member's business of forestry and cropping (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of Timber Produce and Crop Produce) 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 fees is identifiable from the arrangement. The fees appear to be reasonable. There is no capital component of the fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMG

99. 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 (e.g. 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.

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

Sections 82KZME and 82KZMF

101. Where 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)).

102. 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.

103. 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 Member in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions are directly related to the activities under the arrangement. If a Member prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

104. There are a number of exceptions to these rules, but for Members 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 Members in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

105. 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.

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

106. 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.

Section 82KZMG

107. Under section 82KZMG(1), expenditure is excluded from the prepayment rules that would otherwise apply, to the extent that the prepaid amount satisfies the requirements of subsections 82KZMG(2) to (4).

108. Subsection 82KZMG(2) requires that the expenditure is

- incurred on or after 2 October 2001 and on or before 30 June 2006; and
- the eligible service period must be 12 months or shorter and must end on or before the last day of the year of income after the expenditure year; and
- for the doing of a thing under the agreement that is not to be wholly done within the expenditure year.

109. To satisfy subsection 82KZMG(3) the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling; and
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (a right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and
- either:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or

- (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

110. Under subsection 82KZMG(4) the expenditure incurred by the taxpayer must be paid for 'seasonally dependent agronomic activities' undertaken by the manager during the 'establishment period' for the relevant planting of trees for felling.

111. Subsection 82KZMG(5) defines the 'establishment period to commence at the time that the first 'seasonally dependent agronomic activity' is performed in relation to a specific planting of trees and to conclude with the planting of trees. Where it is necessary to apply a fertiliser or herbicide to the trees at the same time as planting then those activities fall within the establishment period. Planting of trees refers to the main planting of the particular plantation and expressly excludes specific planting to replace existing seedlings that have not survived.

Application of the prepayment provisions to this Project

Initial Services Fee – Forest Lot

112. Under the Project Management Agreement, a Member incurs an Initial Services Fee consisting of expenditure of \$3,718 for 'seasonally dependent agronomic activities'.

113. As the requirements of section 82KZMG have been met, a deduction is allowable in the income year ended 30 June 2004 for 2004 Members and 30 June 2005 for 2005 Members for the expenditure incurred under the Management Agreement for 'seasonally dependent agronomic activities'.

Initial Services Fee – Crop Lot and Management Fees

114. The expenditure incurred by a Member in the Project for the Initial Services Fee – Crop Lot and Management Fees – Forest Lot and Management Fees – Crop Lot meet the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

115. The prepaid Initial Services Fee – Crop Lot, the prepaid Management Fees – Forest Lot and the prepaid Management Fees – Crop Lot, being amounts of less than \$1,000 in each expenditure year, constitute ‘excluded expenditure’ as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) ‘excluded expenditure’ is specifically excluded from the operation of section 82KZMF. A Member who is an ‘STS taxpayer’ for the 2005 and prior income years or is an ‘STS taxpayer’ using the cash accounting method for the 2006 and later income years can, therefore, claim an immediate deduction for the Initial Services Fee – Crop Lot and the Management Fees in the income year in which they are paid. A Member who is not an ‘STS taxpayer’ for the 2005 and prior income years or is an ‘STS taxpayer’ using the accruals accounting method for the 2006 and later income years, can claim an immediate deduction for the Initial Services Fee – Crop Lot and the Management Fees in the income year in which they are incurred.

116. However, where a Member acquires more than 1 interest in the Project and the quantum of the prepaid Initial Services Fee – Crop Lot is \$1,000 or more and where a Member acquires more than 5 interest in the Project and the quantum of the prepaid Management Fees – Forest Lot and Management Fees – Crop Lot is each \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

Rent and Variable Costs

117. The Project Management Agreement also requires that a Member incurs Variable Costs for the Forest Lot and the Crop Lot on or before 30 June in each year for the variable cost of insurance, fertilising, harvesting, weed and pest control and all other related forestry and cropping costs during the term of the Project. Under the Sub-lease Agreement a Member incurs Rent – Forest Lot and Rent – Crop Lot to sub-lease land on which the Member’s Forest Lot and Crop Lot are situated during the term of the Project.

118. The Variable Costs incurred under the Project Management Agreement and the Rent incurred under the Sub-lease Agreement are not prepaid. These fees are charged for providing ongoing forestry and cropping services and for the sub-lease of the land to a Member until 30 June of the year in which the fees are incurred.

119. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the Variable Costs and the Rent.

120. A Member who is an ‘STS taxpayer’ for the 2005 and prior income years or is an ‘STS taxpayer’ using the cash accounting method for the 2006 and later income years can, therefore, claim an immediate deduction for each of the relevant fees in the income year in which the fee is paid. A Member who is not an ‘STS taxpayer’ for the 2005 and prior income years or is an ‘STS taxpayer’ using the

accruals accounting method for the 2006 and later income years, can claim an immediate deduction for each of the relevant fees in the income year in which the fee is incurred.

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

121. Although not required under either the Project Management Agreement or the Sub-lease Agreement, a Member participating in the Project may choose to prepay Variable Costs or Rent for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 119 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

122. For these Members, the amount and timing of deductions for any relevant prepaid Variable Costs or prepaid Rent will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

123. 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.

Deferral of losses from non-commercial business activities

Division 35

124. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-5 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

125. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

126. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

127. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Whether a business is made up of one or two or more separate and distinct business activities will be a question of fact. In certain situations their business activities may be so discrete in character and in the manner they are conducted that the question arises whether they are carrying on separate and distinct business activities for the purposes of Division 35.

128. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain).

129. Whether a Member is conducting non Project business activities which may be grouped or whether the primary producer exception applies will depend on the individual circumstances of Members who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

130. A loss from a business activity can be offset against a taxpayer's other income if the activity passes one of the following four tests. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

Separate business activities

131. A Member's forestry activity and cropping activity are separate business activities for the purposes of applying the Commissioner's Discretion under subsection 35-55(1) in respect to the Project. The forestry and cropping activities are so discrete in character and the manner they are conducted, it is considered that they are separate and distinct business activities. The forestry activity is not part of, or incidental to, the cropping activity and vice versa.

132. Information provided with the application for this Product Ruling indicates that the two activities are each capable in their own right of producing assessable income and having attributed to them amounts which would otherwise be deductible. Different types of assets are used in carrying on each activity. There are significant differences in the type of produce and in the conditions affecting the sale and marketing of the produce from each activity.

133. Because the forestry and cropping activities are separate business activities, the discretion under subsection 35-55(1) must be considered independently in respect of each business activity.

Commissioner's Discretion subsection 35-55(1)

134. A Member who participates in the Project will be carrying on a business activity that is subject to the provisions in Division 35. Information provided with the application for this Product Ruling indicates that a Member who acquires the minimum allocation of one Unit in the Project is unlikely to have their forestry activity pass one of the tests until the income year ended 30 June 2023 or their cropping activity pass one of the test until the income year ended 30 June 2007 for 2004 Members or 2008 for 2005 Members. Members who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

135. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Member's participation in the Project.

136. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

137. Information provided with this Product Ruling concerning a Member's Forest Lot indicates that a Member who acquires the minimum investment of one Unit in the Project is expected to be carrying on a business activity that will satisfy one of the tests in the income year ended 30 June 2023, or will produce a taxation profit, for the income years ended 30 June 2013. Information concerning a Member's Crop Lot indicates that a Member who acquires the minimum investment of one Unit in the Project is expected to be carrying on a business activity that will satisfy one of the tests in the income year ended 30 June 2007 for a 2004 Member or 30 June 2008 for a 2005 Member, or will produce a taxation profit, for the income year ended 30 June 2005 for 2004 Members or 30 June 2006 for 2005 Members.

138. The Commissioner will decide for such a Member that it would be reasonable to exercise the second arm of the discretion:

- in relation to a Member's forestry activity for all income years up to, and including:
 - the income year ended 30 June 2023 for 2004 Members; and
 - the income year ended 30 June 2023 for 2005 Members.

The taxation profit that is projected for the income year ended 30 June 2013 does not affect the period of the Commissioner's discretion as it is considered to be a 'one-off' event that is specific to the forestry industry.

- in relation to a Member's cropping activity for all income years up to, and including:
 - the income year ended 30 June 2004 for 2004 Members; and
 - the income year ended 30 June 2005 for 2005 Members.

139. This Product Ruling is issued on a prospective basis (that is, before an individual Member's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 76), in the manner described in the Arrangement (see paragraphs 14 to 54). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Members may need to apply for private rulings on how paragraph 35-55(1) will apply in such changed circumstances.

140. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent forester and additional expert or scientific evidence provided with the application by the Responsible Entity;
- the report of the independent cropping consultant and additional expert or scientific evidence provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the adzuki, barley and maize industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Section 82KL – recouped expenditure

141. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

142. 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).

143. The New World 2020 Project will be a ‘scheme’. A Member will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 73 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.

144. Members to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Timber Produce and the Crop Produce. There are no facts that would suggest that Members 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.

Examples

Example 1 – Entitlement to GST input tax credits

145. 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 2002, 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 1/1/2003 to 30/6/2003 | \$4,400* |
| Carrying out of upgrade of power for your vineyard as quoted | <u>\$2,200*</u> |
| Total due and payable by 1 January 2003 (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 2003, 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).

Example 2 – Apportionment of fees where there is a contractual ‘eligible service period’ and the fees include expenditure that is ‘excluded expenditure’

146. On 1 June 2002 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2002.

Kevin, who is not an ‘STS taxpayer’ is not registered, nor required to be registered for GST.

He calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the \$3,600 in the 2002 income year, because there are no ‘days of eligible service period’ in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2002.

Lease fee

Because the \$500 lease fee is less than \$1,000 it is ‘excluded expenditure’ and can be claimed in full as a tax deduction in Kevin’s tax return for the year ended 30 June 2002.

In the **2003 income year** Kevin can claim a tax deduction for his first year’s management fees calculated as follows:

$$\$3,600 \times \frac{365}{365}$$

= **\$3,600** (this represents the whole of the first year’s management fee prepaid in the 2002 income year but not deductible until the 2003 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Example 3 – Apportionment of Fees

147. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2002 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the 2002 income year as follows:

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

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2002 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2002 income year).

In the 2003 income year Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,644** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2003 income year).

\$4,644 + \$85 = \$4,729 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

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9 June 2004

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