

PR 2006/39 - Income tax: Premium Plantations Hardwood Sawlog Project 2006 (pre 1 July 2006 Growers)



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This document has changed over time. This is a consolidated version of the ruling which was published on *5 April 2006*



Product Ruling

Income tax: Premium Plantations Hardwood Sawlog Project 2006 (pre 1 July 2006 Growers)

Contents	Para
BINDING SECTION:	
What this Ruling is about	1
Date of effect	12
Withdrawal	14
Scheme	15
Ruling	59
NON BINDING SECTION:	
Appendix 1:	
Explanation	72
Appendix 2:	
Detailed contents list	117

① This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

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

Potential participants must form their own view about the commercial and financial viability of the product. 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 and how the product fits an existing portfolio. We recommend a financial (or other) adviser be consulted for such information.

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

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

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling, this scheme is referred to as the 'Premium Plantations Hardwood Sawlog Project 2006' or just simply as 'the Project'.

Relevant taxation provision(s)

2. The relevant taxation provision(s) dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- sections 82KZME to 82KZMG of the ITAA 1936; and
- Part IVA of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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 entities

7. The class of entities to which this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling (refer to paragraphs 59 to 61) and who enter into the scheme specified below on or after the date this Ruling is made. They will have a purpose of staying in the scheme until it is completed (that is, 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 scheme. In this Ruling, these entities are referred to as 'Growers'.

8. The class of entities to whom this Ruling applies does not include entities who:

- are accepted to participate in the Project prior to the date of this Ruling;
- are accepted to participate in the Project after 30 June 2006;
- have their application conditionally accepted by Premium Alternative Investments Limited subject to finance for the payment of the application fee, where the finance has not been approved by the lender or the funds have not been made available to Premium Alternative Investments Ltd by 30 June 2006;
- enter into finance arrangements with financiers associated with Premium Alternative Investments Ltd other than the Commonwealth Bank of Australia; or
- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 58.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 5 April 2006, 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.

13. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)). If a private ruling is inconsistent with a later Product Ruling, the earlier private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the taxation provision(s) ruled upon, to all entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

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

- Application for a Product Ruling dated 10 January 2006 as constituted by documents provided on 11 January 2006, 16 January 2006, 14 February 2006, 17 February 2006, 20 February 2006, 2 March 2006, 7 March 2006, 10 March 2006 and 20 March 2006 and additional correspondence dated 31 January 2006, 14 February 2006, 15 February 2006, 17 February 2006, 3 March 2006, 7 March 2006, 13 March 2006 and 20 March 2006;
- Draft Product Disclosure Statement for the Premium Plantations Hardwood Sawlog Project 2006 received on 10 March 2006;
- Draft Constitution of the Premium Plantations Hardwood Sawlog Project 2006 received on 20 March 2006;
- Draft **Grower Management Agreement – saligna** between Premium Alternative Investments Limited (as Responsible Entity and Grantor) and the Grower received on 14 February 2006;
- Draft **Grower Management Agreement Standard Terms – saligna** between Premium Alternative Investments Limited (as Responsible Entity and Grantor) and the Grower received on 2 March 2006;
- Draft **Grower Lease Agreement – saligna** between Premium Alternative Investments Limited (as Responsible Entity and Grantor) and the Grower received on 11 January 2006;

- Draft **Grower Lease Agreement Standard Terms – saligna** between Premium Alternative Investments Limited (as Responsible Entity and Grantor) and the Grower received on 17 February 2006;
- Draft Head Lease – saligna between the Custodian (as Lessor) and Premium Alternative Investments Ltd (as Lessee) received on 20 March 2006;
- Draft Premium Plantations Land Trust Constitution received on 20 March 2006;
- Draft Sub-Contracting agreement between Premium Alternative Investments Limited and Premium Plantations Services Proprietary Limited received on 20 March 2006;
- Draft Compliance Plan for Premium Plantations Tree Project 2006 received 20 March 2006;
- Draft Land Selection and Acquisition Protocol 2006 received 20 March; and
- Draft **Commonwealth Forestry Loan** – Loan Terms and Mortgage between the Commonwealth Bank of Australia and the Grower received 11 January 2006.

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

16. The documents highlighted (in bold) are those that Growers may enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme to which this Ruling applies.

17. 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

18. The salient features of the Premium Plantations Hardwood Sawlog Project 2006 are as follows:

Location	South West Land Division of Western Australia.
Type of business each participant is carrying on	Commercial growing, cultivation and sale of <i>Eucalyptus saligna</i> (Sydney Blue Gum) trees.
Number of hectares offered for cultivation	6,000 hectares
Minimum subscription	2,000 Timberlots
Size of each Timberlot	0.25 hectares
Minimum allocation per Grower	2 Timberlots
Number of Trees per Timberlot	250 <i>Eucalyptus saligna</i>
The term of the Project	Approximately 21 years
Initial minimum cost	\$9,000 for 2 Timberlots
Ongoing and other costs	Planting Fee, Annual Services, Rent, Tree Insurance, Costs of Harvesting, Costs of Felling, Costs of Sale, Costs of Rehabilitation, Additional Payment and Marketing Performance Bonus

The Project

19. The Project will be a Managed Investment Scheme under the *Corporations Act 2001*. Premium Alternative Investments Limited, which is a wholly owned subsidiary of the Commonwealth Bank of Australia, will be the Responsible Entity of the Project. Premium Alternative Investments Limited has been issued with Financial Services Licence Number 297016 by ASIC. Offers for interests in the Project will be made under a Product Disclosure Statement. Under the Product Disclosure Statement, the Responsible Entity will offer 24,000 interests of 0.25 hectares in size. The Responsible Entity may accept oversubscriptions where sufficient suitable land is able to be sourced.

20. The Project will be conducted on farm land in the South West Land Division of Western Australia within economic haulage distances of established local processing facilities or the ports in Bunbury and Albany.

21. The Project consists of both a Tree Project and a Land Trust. Entities may choose to participate in the Tree Project, the Land Trust or both.

22. The Tree Project involves Growers each conducting a business of primary production through the commercial growing and cultivation of *Eucalyptus saligna* (*E. saligna*) trees and the sale of the produce.

23. The Land Project gives an opportunity to the Growers participating in the Project and others to acquire Units in the Land Trust that will own the Project land. Growers who are also Unit Holders may receive distributions from the Land Trust after the timber of each plantation species is harvested and sold and when the Project ends they may receive distributions from land sale proceeds. The tax treatment of costs associated with the Land Trust, apart from the interest costs of a Commonwealth Bank of Australia loan used to acquire the Unit(s) in the Land Trust is outside the scope of this Ruling.

24. By completing the Application in the Product Disclosure Statement, an Applicant can apply for two or more Timberlots and participate in the Tree Project and/or can apply for two or more Units in the Land Project. A Timberlot is 0.25 hectares of *E. saligna*.

25. A Grower who is accepted into the Tree Project will enter into a Grower Management Agreement for the *E. saligna* trees. Under this Agreement, the Responsible Entity agrees to lease Timberlots to the Grower.

26. The Grower Management Agreement also provides that the Responsible Entity will be responsible for establishing and cultivating the Trees. The Responsible Entity will also arrange for the harvest and sale of the timber on the Grower's behalf.

27. On application for the Timberlots and/or Units, Growers will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required. This will include the execution of the Grower Lease and the Grower Management Agreement.

28. Growers 'Applications' accepted on or before 30 June 2006 will commence participation as 'round one Growers'. **This Ruling only applies in respect of 'round one Growers' (pre 1 July 2006 Growers).** Note that Product Ruling PR 2006/40 may apply to Growers who will enter into the Project during the period 1 July 2006 to on or before 30 September 2006.

Tree Project Constitution

29. The Tree Project Constitution (the 'Constitution') sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers of the Tree Project. Growers are bound by the Constitution by virtue of their participation in the Tree Project. Pursuant to Clause 32 of the Constitution, the Responsible Entity must keep a register of Growers.

30. Under the terms of the Constitution, the Responsible Entity must deposit all Application Moneys received from Growers into a trust bank account they have established for this purpose. This account is referred to as an Application Fund. The Application Moneys will be released from this fund when the Responsible Entity is satisfied that certain specified criteria in the Constitution have been met (clauses 3.3, 5, 7 and 8 of the Constitution).

31. The proceeds from the sale of the Forest Produce will be paid into a Proceeds Fund to be established by the Responsible Entity. A Grower's 'Proportional Interest' in these proceeds will be distributed to the Grower after deducting amounts listed in clauses 29 and 34.2 of the Constitution. In the event of a partial or total destruction of the Trees on a Grower's Timberlots, the Grower's Proportional Interest in the distribution will be reduced to reflect the destruction (clause 1 definition of 'Proportional Interest' in the Constitution). If the Responsible Entity determines that amounts in the Proceeds Fund are too small to be distributed, the Responsible Entity may postpone distribution of those amounts until it determines that a reasonable amount is available for distribution (clause 35.5 of the Constitution).

Compliance Plan

32. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. 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.

Grower Lease Agreement

33. Under the Grower Management Agreement – *saligna* (the 'Grower Management Agreement'), the Responsible Entity agrees to lease Timberlots specified in the Agreement to the Growers within 9 months following the Commencement Date of the Grower Management Agreement.

34. The Responsible Entity will acquire the Project land and transfer the land to the Land Trust. The Responsible Entity will then sub-lease the land to the Growers by entering into the Grower Lease Agreement – *saligna* (the 'Grower Lease Agreement') with each Grower. The Grower Lease Agreement will enable Growers to use their Timberlots for the purpose of conducting their afforestation business upon terms and conditions as set out in the lease.

35. The lease will continue until the completion of the final harvest in approximately 21 years for the *E. saligna* trees (item 6 of the Schedule to the Grower Lease Agreement).

36. As specified in the 'Fees' section below, Rent is deferred and is payable at the rate of 11% from the Net Proceeds of Sale.

37. The Responsible Entity will arrange Tree Insurance for the Timberlots annually to cover for the destruction of the Growers' trees by fire. The Tree Insurance will be paid for by the Grower. However, if in the opinion of the Responsible Entity, the cost of the Tree Insurance is not reasonable, the Responsible Entity is not obliged to procure the Tree Insurance and the Growers will be at liberty to take out their own Tree Insurance cover (clauses 5.4 and 12 of the Grower Lease Agreement Standard Terms).

Grower Management Agreement

38. The Grower Management Agreement is entered into between the Responsible Entity and each Grower. Each Grower agrees to engage the Responsible Entity to perform the Services listed in the Grower Management Agreement in respect of each Grower's Timberlots. The Responsible Entity may employ an agent or contractor to carry out some or all of these Services and will do so by engaging Premium Plantations Services Proprietary Limited.

39. The 'Initial Services' provided for under the Grower Management Agreement must be completed during the period from 1 July 2006 to 30 June 2007. However, these services will only be conducted after the Timberlots are leased to the Grower. The Initial Services include:

- ripping and mounding the Timberlots as necessary from the 1 July 2006;
- otherwise preparing the Timberlots for planting as necessary from the 1 July 2006; and
- procurement of sufficient *E. saligna* seedlings or trees of appropriate size as is reasonably required to complete the Planting Services (clause 1 (definition of 'Initial Services') and clause 5 of the Grower Management Agreement Standard Terms).

40. 'Planting Services' will be performed in the period from 1 April 2007 to 31 December 2007 after the Initial Services have been completed. The Planting Services require that 250 *E. saligna* seedlings or Trees are planted on a Timberlot (clause 1 (definition of 'Planting Services') and clause 5 of the Grower Management Agreement Standard Terms).

41. Services that will be provided throughout the Project Term are the 'Annual Services', which include:

- cultivating, tending, culling, fertilising, replanting, spraying and otherwise caring for the Trees as and when required;
- keeping in good repair and condition any access roads and firebreaks, as required;
- undertaking pest control measures;

- obtaining a Report within 4 months after the completion of planting of all plantations and then yearly, to be furnished to the Grower;
- organising and arranging for the Trees to be fertilised; and
- obtaining all necessary approvals and consents required in relation to the provision of the above services.

42. In consideration of the Responsible Entity agreeing to carry out the Initial Services an Establishment Fee is payable on or before 30 June 2006. For the Planting Services a Planting Fee is payable on or before 30 June 2007 and for the Annual Services the fee is a percentage payable from the Net Proceeds of Sale.

Thinning, harvesting and sale

43. The Growers will appoint the Responsible Entity to arrange for the thinning, harvesting and sale of the Forest Produce grown on the Growers' Timberlots (clauses 7 and 8 of the Grower Management Agreement Standard Terms).

44. The Responsible Entity expects to conduct a final harvest of the *E. saligna* trees at age 20 years.

45. After the final harvest, the produce from each Grower's Timberlots will be pooled with other Growers' produce from the Project and sold by the Manager on behalf of the Growers. The Responsible Entity will use its best endeavours to negotiate the sale of the produce to achieve the greatest Net Proceeds of Sale for each Grower having regard to the circumstances at the time (clause 8 of the Grower Management Agreement Standard Terms).

The Land Project (optional)

46. A Grower **may** purchase Units in the Land Trust that owns the land leased to Growers in the Project.

47. The Land Trust Constitution establishes the Trust and operates as a deed under which Premium Alternative Investments Ltd holds assets on trust for the Unitholders. It sets out the terms and conditions under which Premium Alternative Investments Ltd agrees to act as the Trustee for the trust.

48. The beneficial interest in the Trust is divided into Units and each Unit confers an equal undivided interest in the assets of the Trust.

49. The subscription price for the Land Trust is \$375 per Unit and is payable by 30 June 2006 (items 3.2 and 12.3 of the Product Disclosure Statement).

50. The subscription price represents the value of a quarter of a hectare of *E. saligna* land encumbered by the Tree Project Growers' Leases.

Fees

51. The Grower must pay the following amount to the Responsible Entity Limited for each Timberlot:

- **Establishment Fee** of \$4,500 payable on or before 30 June 2006 for Initial Services to be performed from 1 July 2006 to 30 June 2007 (item 4 of the Schedule to the Grower Management Agreement);
- **Planting Fee** of \$250 payable on or before 30 June 2007 for Planting Services to be performed from 1 April 2007 to 31 December 2007 (item 4 of the Schedule to the Grower Management Agreement);
- **Annual Services Fee**, being 5.5% of the Net Proceeds of Sale. This fee is for Annual Services and is deducted from the Net Proceeds of Sale (item 4 of the Schedule to Grower Management Agreement);
- **Rent** being 11% of the Net Proceeds of Sale. This fee is for the Grower's lease and is deducted from the Net Proceeds of Sale (item 7 of the Schedule to the Grower Lease Agreement);
- **Tree Insurance** payable annually beginning on 1 July 2007. The amounts payable will be advised by the Responsible Entity (clauses 5.4 and 12 of the Grower Lease Agreement Standard Terms and item 6.5 of the Product Disclosure Statement);
- **Costs of Harvesting, Costs of Felling, Costs of Sale and Costs of Rehabilitation** to be deducted from the Gross Proceeds of Sale (clause 10 of the Grower Management Agreement Standard Terms);
- **Additional Payment** as advised by the Responsible Entity for costs incurred by the Responsible Entity for additional Services to those listed in the Grower Management Agreement, where the services are required by reason of an unforeseen event or a change of a law or a significant change to silvicultural practices (clause 14 of the Grower Management Agreement Standard Terms); and
- **Marketing Performance Bonus**, equal to 11% of the excess of the *E. saligna* Net Proceeds of Sale for the entire Project over the number of Timberlots in the Project multiplied by \$12,500 (item 4 of the Schedule to the Grower Management Agreement).

52. If all, or substantially all of the trees are destroyed before the harvests can take place due to an event for which there is no current insurance policy at the time of the event, the Grower will be liable to pay an amount of \$22 per Timberlot per year in respect of Annual Services and \$44 per Timberlot per year in respect of Rent up to the time the trees are destroyed (clause 12(m) of the Grower Lease Agreement Standard Terms).

Finance

53. Growers can fund their investment in the Project themselves, borrow from Commonwealth Bank of Australia (a lender associated with the Responsible Entity) or borrow from an independent lender.

54. The Commonwealth Bank of Australia will offer two finance arrangements, described as 'Commonwealth Forestry Loans' (section 13 of the Product Disclosure Statement):

Option 1: Reducing loan over one year interest free

- no deposit required;
- no interest is applicable; and
- repayable in equal monthly payments over 1 year, with the first repayment due on 31 July 2006.

Option 2: Ten year fixed rate loan (ten years principal and interest)

- no deposit required;
- fixed interest rate of 7.5% per annum (an indicative rate only);
- further drawdown option for the Planting Fee; and
- repayable in 120 monthly payments amortising the loan balance to nil. The first payment is due on 31 July 2006.

55. The interest rate is only indicative. The actual interest rate for the loans will be set by the Commonwealth Bank of Australia on the loan drawdown date.

56. The loans are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a mortgage over the Grower's interests in the Project.

57. This Ruling will not apply to Growers who enter into finance arrangements with the Commonwealth Bank, with terms and conditions that differ in any way from those set out in paragraphs 54 to 56.

58. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;

- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than the Commonwealth Bank of Australia are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

59. Subject to paragraph 8, this Ruling applies only to Growers who are accepted to participate in the Project on or before 30 June 2006 as 'round one Growers' (pre 1 July 2006 Growers) and who have executed the Grower Management Agreement – saligna on or before that date.

60. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

61. The Ruling does not apply to:

- Growers whose application has been conditionally accepted by the Responsible Entity subject to finance for the payment of the application fee, where the finance has not been approved by the lender and funds have not been made available to the Responsible Entity by 30 June 2006; or
- Growers who enter into finance arrangements with entities associated with the Responsible Entity other than the finance arrangements described at paragraphs 54 to 56 with the Commonwealth Bank of Australia.

Minimum subscription

62. 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 Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 2,000 interests is achieved.

The Simplified Tax System (STS)***Division 328***

63. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS Taxpayer' and must have elected to be an 'STS taxpayer'. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

64. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneurs tax offset***Subdivision 61-J***

65. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides a 25% tax offset of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable income***Section 6-5***

66. 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.

67. A Grower will recognise ordinary income from carrying on the business of afforestation at the time that income is derived.

**Deductions for the Establishment Fee, Planting Fee,
Tree Insurance and interest****Section 8-1**

68. A Grower may claim tax deductions under section 8-1 for the revenue expenses set out in the Table below.

Tree Project (per Timberlot)

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Establishment Fee	\$4,500 See Notes (i) & (ii)		
Planting Fee		\$250 See Notes (i) & (ii)	
Tree Insurance			See Notes (i) & (iii)
Interest	See Note (iv)	See Note (iv)	See Note (iv)

69. A Grower who participates in the Tree Project and the Land Project may also claim tax deductions under section 8-1 for the revenue expenses set out in the Table below.

Land Project

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Interest	See Note (iv)	See Note (iv)	See Note (iv)

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.
- (ii) Under section 82KZMG of the ITAA 1936 the fees for the Initial Services and the Planting Services consist of expenditure for 'seasonally dependent agronomic activities' (see paragraphs 103 to 107) and are deductible in the income year in which they are incurred.
- (iii) The annual Tree Insurance premium payable to the Responsible Entity from 1 July 2007 is deductible in the year in which it is incurred.

- (iv) Interest paid to the Commonwealth Bank (under the arrangements described at paragraphs 54 to 56) is deductible in the year in which it is incurred. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than the Commonwealth Bank of Australia, the internal financier, is outside the scope of this Ruling. However all Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 95 to 102 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.

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

Section 35-55 – exercise of Commissioner's discretion

70. A Grower who is an individual accepted into the Project on or before 30 June 2006 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 2006 to 30 June 2027**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

Section 82KL and Part IVA

71. For a Grower who participates in the Project and incurs expenditure as required by the Grower Management Agreement and the Grower 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 taxation provision dealt with in this Ruling.

Commissioner of Taxation

5 April 2006

Appendix 1 – Explanation

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

Is the Grower carrying on a business?

72. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's afforestation activities as a participant in the Project must amount to the carrying on of a business of primary production.

73. Where there is a business, or a future business, the gross proceeds from the sale of the wood 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.

74. For schemes such as that of the 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.

75. Generally, a Grower will be carrying on a business of afforestation, and hence primary production, if:

- the Grower has an identifiable interest in land (by lease) or rights over the land (by licence) on which the Grower's trees are established;
- the Grower has a right to harvest and sell the wood produce from those trees;
- the afforestation activities are carried out on the Grower's behalf;
- the afforestation activities of the Grower are typical of those associated with a afforestation business; and
- the weight and influence of general indicators point to the carrying on of a business.

76. In this Project, each Grower enters into a Grower Management Agreement and a Grower Lease Agreement.

77. Under the Grower Lease Agreement each individual Grower will have rights over a specific and identifiable area of at least 0.5 hectares of land. The lease provides the Grower with an ongoing interest in the specific 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 afforestation activities, and for no other purpose. The lease allows the Responsible Entity to come onto the land to carry out its obligations under the Grower Management Agreement.

78. Under the Grower Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain 'Timberlots' on the Grower'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 services to establish and maintain the Timberlots on the Grower's behalf.

79. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the wood produce grown on the Grower's Timberlots.

80. 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.

81. 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 the wood 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.

82. The pooling of wood produce from trees grown on the Grower's Timberlots with the wood produce of other Growers is consistent with general afforestation practices. Each Grower's proportionate share of the sale proceeds of the pooled wood produce will reflect the proportion of the trees contributed from their Timberlots.

83. The Responsible Entity's services are also consistent with general silvicultural practices. They are of the type ordinarily found in afforestation ventures that would commonly be said to be businesses. While the combined size of the Timberlots is relatively small, the Grower's interest is of a size and scale to allow it to be commercially viable.

84. The Grower's degree of control over the Responsible Entity as evidenced by the Grower Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the Term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Timberlots and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as in cases of default or neglect.

85. The afforestation 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' afforestation activities in the Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

86. 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.

87. 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 Establishment Fee, Planting Fee and Tree Insurance

Section 8-1

88. Consideration of whether the Establishment Fee, Planting Fee and Tree Insurance 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.

89. The Establishment Fee, Planting Fee and Tree Insurance associated with the afforestation activities will relate to the gaining of income from the Grower's business of afforestation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of wood 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 fee is identifiable from the scheme. The fee appears to be reasonable. There is no capital component of the Establishment Fee, Planting Fee and Tree Insurance. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

Section 8-1

(i) Growers who use the Commonwealth Bank of Australia as the finance provider

90. Some Growers may finance their participation in the Project through a loan facility with the Commonwealth Bank of Australia. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the Establishment Fee, Planting Fee and Tree Insurance payable under the Grower Management Agreement.

91. The interest incurred for the year ended 30 June 2006 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

92. In the absence of any application of the prepayment provisions (see paragraphs 95 to 102), interest is deductible in the year in which it is incurred.

(ii) Growers who DO NOT use the Commonwealth Bank of Australia as the finance provider

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

94. 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 95 to 102).

Prepayment provisions

Sections 82KZL to 82KZMG

95. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example, the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

96. For this Project, only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936 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

97. Other than expenditure deductible under section 82KZMG of the ITAA 1936, if the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (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)).

98. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the agreement (or scheme) 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;
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the scheme 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.

99. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4) of the ITAA 1936). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier not associated with the Project. Although undertaken with an unrelated party, that financing would be an element of the scheme. The funds borrowed and the resulting interest deduction are directly related to the activities under the scheme. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

100. 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) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. For the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the scheme that is less than \$1,000. Such expenditure is immediately deductible.

101. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 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.

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

102. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) 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

103. Under subsection 82KZMG(1) of the ITAA 1936, 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).

104. Subsection 82KZMG(2) of the ITAA 1936 requires that the expenditure is:

- incurred on or after 2 October 2001 and on or before 30 June 2008;
- 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.

105. To satisfy subsection 82KZMG(3) of the ITAA 1936 the agreement must satisfy the following requirements:

- it must be an agreement for planting and tending trees for felling;
- 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.

106. Under subsection 82KZMG(4) of the ITAA 1936 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. The term 'seasonally dependent agronomic activities' is explained in Taxation Determination TD 2003/12.

107. Subsection 82KZMG(5) of the ITAA 1936 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

Establishment Fee and Planting Fee

108. Under the Grower Management Agreement, a Grower incurs fees for Initial Services and Planting Services. These fees consist of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG of the ITAA 1936 are met, a deduction is allowable in the same year as the expenditure is incurred.

Interest

109. Growers who borrow funds in order to participate in the Project, other than from the Commonwealth Bank under the finance arrangements described at paragraphs 53 to 55, may either choose, or be required to prepay interest. Where this occurs, section 82KZMF of the ITAA 1936 will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

110. However as noted above, prepaid interest of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will not be subject to apportionment under section 82KZMF of the ITAA 1936.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – exercise of Commissioner’s discretion***

111. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2006 to 30 June 2027**, 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:

- 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 afforestation 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.

112. 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

113. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

114. For Part IVA of the ITAA 1936 to apply there must be a ‘scheme’ (section 177A), a ‘tax benefit’ (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

115. The Project will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 68 and 69 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.

116. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the wood produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936, it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

117. Below is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant taxation provisions(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of entities	7
Qualifications	9
Date of effect	12
Withdrawal	14
Scheme	15
Overview	18
The Project	19
Tree Project Constitution	29
Compliance Plan	32
Grower Lease Agreement	33
Grower Management Agreement	38
Thinning, harvesting and sale	43
The Land Project (optional)	46
Fees	51
Finance	53
Ruling	59
Application of this Ruling	59
Minimum subscription	62
The Simplified Tax System (STS)	63
<i>Division 328</i>	63
25% entrepreneurs tax offset	65
<i>Subdivision 61-J</i>	65
Assessable income	66
<i>Section 6-5</i>	66
Deductions for the Establishment Fee, Planting Fee, Tree Insurance and interest	68
<i>Section 8-1</i>	68

Division 35 – deferral of losses from non-commercial business activities	70
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	70
Section 82KL and Part IVA	71
Appendix 1 – Explanation	72
Is the Grower carrying on a business?	72
The Simplified Tax System	86
<i>Division 328</i>	86
Deductibility of Establishment Fee, Planting Fee and Tree Insurance	88
<i>Section 8-1</i>	88
Interest deductibility	90
<i>Section 8-1</i>	90
(i) Growers who use the Commonwealth Bank of Australia as the finance provider	90
(ii) Growers who DO NOT use the Commonwealth Bank of Australia as the finance provider	93
Prepayment provisions	95
<i>Sections 82KZL to 82KZMG</i>	95
<i>Sections 82KZME and 82KZMF</i>	97
<i>Section 82KZMG</i>	103
Application of the prepayment provisions to this Project	108
<i>Establishment Fee and Planting Fee</i>	108
<i>Interest</i>	109
Division 35 – deferral of losses from non-commercial business activities	111
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	111
Section 82KL – recouped expenditure	113
Part IVA – general tax avoidance provisions	114
Appendix 2 – Detailed contents list	117

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

PR 2006/40; TR 97/11; TR 98/22;
TR 2000/8; TR 2001/14; TD 2003/12

Subject references:

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

- ITAA 1936 82KZME(2)
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- ITAA 1936 82KZME(4)
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- ITAA 1936 82KZMF
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