

PR 2008/68 - Income tax: Gunns Plantations Woodlot Project 2009 - Option 3

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 April 2009*



Product Ruling

Income tax: Gunns Plantations Woodlot Project 2009 – Option 3

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

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

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

If you rely on this ruling, 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.

[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

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. 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.

Terms of use of this Product Ruling

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

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Product Ruling this scheme is referred to as the scheme, the 'Gunns Plantations Woodlot Project 2009 – Option 3', or simply as 'the Project'.

2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. Where used in this Ruling, the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this Ruling, terms defined in the Project agreements have been capitalised.

Class of entities

3. This part of the Product Ruling specifies which entities:

- are subject to the taxation obligations; and
- can rely on the taxation benefits;

set out in the Ruling section of this Product Ruling.

4. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to in this Product Ruling as Growers.

5. Growers are those entities that:

- meet the definition of 'initial participant' in subsection 394-15(5); and
- are accepted to take part in the scheme specified below on or after the date this Product Ruling is made.

6. A Grower will have executed the relevant Project Agreements set out in paragraph 45 of this Ruling on or before 30 June 2009 and will hold a 'forestry interest' in the Project.

7. The class of entities who can rely on this Product Ruling does **not** include:

- Growers who are accepted into this Project before the date of this Ruling or after 30 June 2009;
- Growers who participate in the scheme through offers made other than through the Product Disclosure Statement;
- Growers who enter into the Project under Options 1 or 2, or the Blended Option;

- Growers whose Application Fees, including all loan moneys, are not paid in full to Gunns Plantations Ltd (GPL) by 30 June 2009, either by the Grower and/or on the Grower's behalf by a lending institution; or
- Growers who enter into finance agreements with Gunns Finance Pty Ltd outside the terms specified in paragraphs 91 to 93 of this Ruling.

Qualifications

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 45 to 95 of this Ruling.

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

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

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Superannuation Industry (Supervision) Act 1993

11. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Date of effect

12. This Product Ruling applies prospectively from 15 October 2008, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 15 October 2008 until 30 June 2009, being the closing date for entry into the 2009 scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for all income years up to the income year in which the scheme is terminated in accordance with the Project Constitution.

13. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

14. 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)).

15. If this Product Ruling is inconsistent with an earlier private ruling, the 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.

16. 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).

Changes in the law

17. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments to the law may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to the extent of those amendments this Product Ruling will be superseded.

18. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

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

Goods and services tax

20. All fees and expenditure referred to in this Product Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in any creditable acquisition that it makes it must be registered or required to be registered for GST and hold a valid tax invoice.

21. [Omitted.]

Ruling

Structure of the Project

22. The Gunns Plantations Woodlot Project 2009 is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Under Option 3, its purpose is the establishment and tending of Pine trees for felling in Australia.

23. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for an 'initial participant'¹ in the defined class of entities (see paragraphs 4 to 7 of this Ruling) who is accepted to participate in the 'forestry managed investment scheme' described at paragraphs 45 to 95 of this Ruling between 15 October 2008 and 30 June 2009 inclusive.

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

¹ See subsection 394-15(5).

² See section 394-30.

Carrying on a business

24A. Although not relevant for the purposes of Division 394, a Grower (as described in paragraphs 4 to 6 of this Ruling) who will stay in the Project until it is completed will be considered to be carrying on a business of primary production. Such Growers who are individuals will be subject to the operation of Division 35 (see paragraphs 43A to 43B of this Ruling).

The '70% DFE rule' and the establishment of the trees

25. The taxation obligations and benefits set out below have been determined using the information provided to the Commissioner by GPL. On the basis of that information, the Commissioner has decided that on 30 June 2009 it will be reasonable to expect that the '70% DFE rule'³ will be satisfied. The Tax Office may undertake review activities during the term of the Project to verify the information relied on for the purposes of the '70% DFE rule'.

26. The Ruling will only apply if GPL establishes all of the Trees that were intended to be established under the Project within 18 months of the end of the income year in which the first 'participant' in the Project is accepted.⁴ For this Project the Trees must be established by 31 December 2010.

27. In the context of this Project, the Trees will be established when they are planted on the land acquired for the purposes of the Project at the average rate of 1,333 trees per hectare. GPL is required by section 394-10 of Schedule 1 of the TAA to notify the Tax Office if the Trees are not established by 31 December 2010.

Allowable deductions

Sections 8-5, 394-10 and 394-20

28. A Grower in the Project can claim deductions for the amounts shown in the Table below that are paid to GPL (sections 8-5 and 394-10).

29. [Omitted.]

30. The deductibility of these amounts remains subject to a requirement that a CGT event⁵ does not happen in relation to the Grower's 'forestry interest' before 1 July 2013 (see paragraphs 32 to 34 of this Ruling).

³ The '70% DFE rule' is set out in section 394-35.

⁴ See subsection 394-10(4)

⁵ Defined in section 995-1.

31. The amount is deductible in the income year in which it is paid, or is paid on behalf of the Grower (subsection 394-10(2) and section 394-20). Where a Grower does not fully pay an amount, or it is not fully paid on their behalf in an income year, it is deductible only to the extent to which it has been paid. Any unpaid amount is then deductible in the year or years in which it is actually paid.

Fee	Amount	Year(s) deductible
Establishment Fee	\$7,480 See Note (i)	2009
Maintenance Fee	8.8% of Net Wood Sale Proceeds	Any year in which this amount is paid See Note (ii)
Rent	5.5% of Net Wood Sale Proceeds	Any year in which this amount is paid See Note (ii)
Sales Commission	2.2% of Net Wood Sale Proceeds	Any year in which this amount is paid See Note (ii)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of the outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) Growers will be notified by GPL of the years in which these amounts are paid, but harvests are expected to occur in the 2022 and 2027 income years. A clear-fell harvest is expected to take place in 2034.

'CGT event' within 4 years for Growers who are 'initial participants'**Subsections 394-10(5) and (6)**

32. A deduction for the Establishment Fee is not allowable where a 'CGT event' happens in relation to the 'forestry interest' of a Grower before 1 July 2013 (subsection 394-10(5)).

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

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

Insurance costs and interest on loans to finance the 'forestry interest' of a Grower**Section 8-1**

35. Any amounts incurred by a Grower to insure their Trees will be deductible under section 8-1. Insurance premiums and associated administration charges are allowable in the year in which the insurance costs are incurred. GPL will advise the Grower each year of relevant amounts.

36. A Grower in the Project can claim deductions for interest incurred on a loan to fund their investment in the Project (paragraph 8-1(1)(a)). This Ruling only applies to loans between a Grower and Gunns Finance Pty Ltd. Growers who borrow from other financiers may apply for a private ruling on the deductibility of loan interest or may self assess the deductibility of the interest.

Borrowing costs**Section 25-25**

37. The Loan Establishment Fee payable to Gunns Finance Pty Ltd of \$150 plus 0.4% of the loan amount is a borrowing expense and is deductible under section 25-25.

38. The deduction for the borrowing expense must be calculated. The amount deductible will depend on the term of the loan.

Loan Term	Amount	Year(s) deductible
12 months or 3 years	Must be calculated	See Note (iii)
5, 10 or 15 years	Must be calculated	See Note (iv)

Notes:

- (iii) For loan terms of 12 months or 3 years, the deduction for the borrowing expense is spread over the period of the loan on a straight line basis from the date the loan begins.
- (iv) For loan terms of 5, 10 or 15 years, the deduction for the borrowing expense is spread over 5 years on a straight line basis from the date the loan begins.

39. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Gunns Finance Pty Ltd is outside the scope of this Ruling.

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

40. Where a 'CGT event' (other than a 'CGT event' in respect of a thinning⁶ – see paragraph 43 of this Ruling) happens to a 'forestry interest' held by a Grower in this Project the market value of the 'forestry interest', or the decrease in the market value of the 'forestry interest', is included in the assessable income of the Grower (sections 6-10 and 394-25).

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

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

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

Amounts received by Growers where the Project trees are thinned**Section 6-5**

43. An amount received by a Grower in respect of a thinning of the trees grown in this Project is not received as a result of a 'CGT event' and is not otherwise assessable under Division 394. The amount is a distribution of ordinary income that arises as an incident of a Grower holding a 'forestry interest' in the Project. Growers include amounts received for thinning the trees in their assessable income in the income year in which the amounts are derived (section 6-5).

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

43A. A Grower who will stay in the Project until its completion will be considered to be carrying on a business of primary production. Such a Grower, who is an individual, and accepted into the Project in the year ended 30 June 2009, may make losses from the Project that may be affected by the loss deferral rule in section 35-10. Division 35 does not apply however, to Growers who do not carry on a business.

⁶ A thinning of the trees includes a selective harvest of immature trees to facilitate better outcomes at harvest. A thinning differs from a clear fell of a percentage of mature trees which may occur over two or more income years.

43B. The discretion in paragraph 35-55(1)(b) will be exercised for a Grower to whom the loss deferral rule would otherwise apply, for the income years ended 30 June 2009 to 30 June 2033. Exercise of the discretion in this case however is conditional on the Project being carried out in the manner described in paragraphs 45 to 95 of this Ruling, but will allow Growers referred to who make losses, to offset them against their other assessable income in the income years in which those losses arise.

Prepayment provisions and anti-avoidance provisions

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

44. Where a Grower is accepted to participate in the Project set out at paragraphs 45 to 95 of this Ruling, the following provisions have application as indicated:

- interest paid by a Grower to Gunns Finance Pty Ltd does not fall within the scope of sections 82KZM, 82KZME and 82KZMF of the ITAA 1936;
- section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA of the ITAA 1936 will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 11 June 2008, 16 June 2008 and 11 September 2008 and additional documents and correspondence between GPL and the Tax Office received on 27 June 2008, 23 July 2008, 13, 20 and 29 August 2008, 1 October 2008 and 9, 13, 18, 20, 24 and 25 March 2009;
- Draft Product Disclosure Statement for the Project, received 11 September 2008;
- Draft Constitution for the Gunns Plantations Limited Woodlot Project 2009, received 11 June 2008;
- Draft Compliance Plan for the Project, received 11 June 2008;
- Draft Forestry Right Deed between the owner of the Land (as Landowner) and GPL, received 11 June 2008;

- Draft **Sub-Forestry Right Deed** between GPL and the Grower, received 11 June 2008;
- Draft **Agreement to Grant a Sub-Forestry Right** between GPL and the Grower, received 11 June 2008;
- Draft **Management Agreement** between GPL (as Manager) and Gunns Limited and the Grower, received 11 June 2008;
- Deed Poll by Gunns Limited in favour of the Growers, received 11 June 2008;
- Draft Establishment Services Sub-Contract and Draft Maintenance and Pruning Services Sub-Contract, received 11 June 2008;
- Draft Wood Sale Agreement received 11 June 2008; and
- Draft Custody Agreement between GPL (as Trustee) and Gunns Limited (as Custodian), received 11 June 2008.

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

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

47. The documents highlighted are those that a Grower 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. The effect of these agreements is summarised as follows.

Overview

48. The Project will involve the establishment of commercial Eucalyptus and Pine plantations under three options of varying terms. There is also a Blended Option whereby a Grower can invest in a fixed ratio of the first three options. This Product Ruling only applies to Option 3 – a 25 year sawlog and pulpwood rotation of Pine trees in Tasmania and the Southern Highlands region of New South Wales. Options 1 and 2 and the Blended Option are covered by separate Product Rulings.

49. The main features for Option 3 of the Gunns Plantations Woodlot Project 2009 are as follows:

Locations	Tasmania and the Southern Highlands region of New South Wales
Species of trees to be planted under the scheme	Commercial growing of <i>Pinus radiata</i> (Pine)
Term of the Project	25 years
Date all trees are due to be planted on scheme land	31 December 2010
Number of trees per hectare	Minimum average of 1,333
Number of hectares offered for cultivation	10,000 hectares across all options, however, oversubscriptions may be accepted
Size of each 'forestry interest'	One hectare
Minimum allocation of 'forestry interests' per Grower	One
Initial cost	'Application Fee' of \$7,480
Other costs	Growers will be charged for the cost of any insurance except public liability insurance. A fee for sales commission, rental and maintenance will be charged at the time of thinning (Years 13 and 18) and at the end of the Project (Year 25). The fee will equal 16.5% of the 'Wood Sale Proceeds' from the 'Woodlot'.

50. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Gunns Plantations Limited has been issued with an Australian Financial Service Licence 238701 and will be the Responsible Entity for the Project.

51. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer under the PDS is for 10,000 hectares across all options, which corresponds to 10,000 'forestry interests' in the Project. The number of applications accepted under Option 3 will depend on the level of applications received for all options.

52. An entity that participates in the Project as a Grower will do so by acquiring a minimum of one 'forestry interest', of one hectare each, in the Project on or before 30 June 2009.

53. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints GPL to enter into, on behalf of the Grower, an Agreement to Grant a Sub-Forestry Right Deed, a Sub-Forestry Right Deed and a Management Agreement and any other documents required to hold an interest in the Project.

54. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and whose agreements (see paragraph 53 of this Ruling) are executed by 30 June 2009 will become Growers in the 2009 Project.

55. GPL has identified sufficient land to be used for the Project. Under Option 3, land will be secured in Tasmania and the Southern Highlands region of New South Wales. Project land must meet the requirements set out by the Independent Forester as stated in the PDS.

56. This Land will be divided into one hectare lots and sub-leased to the Growers accepted in the Project.

Constitution

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

58. To acquire an interest in the Project, an entity must make an application for 'forestry interests' in accordance with clause 4. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the registered office of the Responsible Entity and accompanied by payment of the Application Money in a form acceptable to the Responsible Entity.

59. Under clause 3.4 of the Constitution, GPL holds the Application money on bare trust and will deposit all Application moneys received from applicants in a Project bank account.

60. Once GPL has accepted the application and all of the Project documents have been executed and remain in force (clause 7) the Application money may be released and applied against the Application Fees due as payment of the Woodlot Establishment Expenses (clause 8).

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

- the general functions, powers and duties of the Responsible Entity (clause 13);
- complaints and dispute resolution (clause 14);
- transfer of Grower's interests (clause 18);

- distributions from the Fund (clause 29); and
- provisions relating to termination (clauses 33 and 34).

Compliance Plan

62. As required by the *Corporations Act 2001*, GPL, as Responsible Entity, has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that GPL manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Forestry Right Deed

63. Each Landowner as the registered proprietor of the Land will grant GPL a Forestry Right Deed over the Land for the Term of the Project. Each Landowner and GPL will sign a Registration Instrument and any other document required to enable the Forestry Right Deed, or any rights established by the grant of the Forestry Right, to be registered against the title or titles to the Land.

64. The Responsible Entity must only use the Land for establishing, planting, tending, maintaining and harvesting the Trees and carrying out the Project.

65. The Responsible Entity may also sub-lease the land or any part of the land to Growers in the Project for a term equivalent to the term of the Forestry Right Deed.

Sub-Forestry Right Deed

66. Each Grower will execute a Sub-Forestry Right Deed with the Responsible Entity as the Grantor. The Responsible Entity will grant to the Grower the right to carry out the Project's tree farming activities (see paragraph 64 of this Ruling) from the Commencement Date.

67. The Grower's and Grantor's rights and obligations are set out in clause 4 and 5 of the Sub-Forestry Right Deed respectively. The Grower has, at all times, full right, title and interest in the Trees and the right to have the Trees sold for their benefit.

68. GPL is entitled to a Rental Fee which will be deducted from the Wood Sale Proceeds.

Agreement to grant a Sub-Forestry Right

69. Where there is no Project land available for a Grower on or before 30 June 2009, the Grower will be required to enter into an Agreement to grant a Sub-Forestry Right with GPL.

70. The deed records the obligations of GPL and the Grower in relation to a Sub-Forestry Right Deed. As soon as reasonably practicable after acceptance of an application, GPL shall prepare and execute a Forestry Right Deed and the Grower shall execute the relevant Sub-Forestry Right Deed in accordance with clause 6 of the Constitution.

71. It is a requirement of its Australian Financial Services Licence that GPL will enter into and lodge for registration the Forestry Right Deed within 15 months after the date of the Grower being accepted into the Project. If the Forestry Right Deed is not lodged for registration within 15 months after the issue of interest in the Project to the Grower, GPL is required to offer the Grower a refund of the Application Fee.

Management Agreement

72. Under the Management Agreement, GPL is appointed as Manager and will carry out Services, defined as Establishment Services and Maintenance Services, on behalf of each Grower.

73. The Establishment Services (clause 4) include, amongst other things:

- ploughing and cultivation required for the purposes of planting;
- procuring the supply of Seedlings to an average density of 1,333 per hectare; and
- planting all Seedlings in accordance with good silvicultural practice.

74. The Manager must use its best endeavours to complete the Establishment Services within 18 months of the end of the financial year in which the Establishment Fee is paid, that is, by 31 December 2010.

75. The Maintenance Services (clause 5) will be provided during the Term of the Sub-Forestry Right Deed. The Manager will replant any trees on a Grower's Woodlot which die for any cause during the first 2 years after the Commencement Date to maintain a minimum stocking level of 90% of the average initial planting density.

76. Each Grower appoints GPL to act as their agent to market and sell their trees (clause 11.1). GPL will enter into a Wood Sale Agreement with a purchaser. A Draft Wood Sale Agreement is attached to the Management Agreement as Schedule 2.

77. If requested by the Grower, the Manager will endeavour to procure insurance cover against destruction or damage of the Grower's Woodlot by fire and other usual risks (clause 13.1).

78. The Manager will be responsible for insuring the Plantation against public risk for an amount of not less than \$20,000,000 during the Term of the Project (clause 13.2).

Subcontractor agreements

79. GPL will subcontract the management services under two separate agreements with Gunns Limited. The Establishment Services Sub-contracting Agreement and the Maintenance and Pruning Services Sub-contracting Agreement require Gunns Limited to perform the services in accordance with the terms and conditions set out in the Management Agreement.

Distribution of Wood Proceeds

80. Clause 29 of the Constitution sets out the arrangements relating to the distribution of proceeds from the sale of the Trees. GPL will distribute the Wood Sale Proceeds among the Growers in accordance with each Grower's proportional interest in those proceeds.

81. Proceeds from each of the Planting Options under the Project will be pooled and distributed separately for the benefit of Growers in each particular Planting Option.

Fees

82. Under the terms of the Management Agreement and the Sub-Forestry Right Deed, a Grower will make payments as described below on a per 'forestry interest' basis.

83. The Project has an upfront Application Fee of \$7,480 which represents the total cost for establishment and planting of each Woodlot.

84. There are no ongoing maintenance fees or rent payable during the course of the Project. These costs, together with the Sales Commission payable to GPL, will be paid out of Wood Sale Proceeds from thinnings in years 13 and 18 and the clear-fell harvest in year 25.

85. The fees to be paid from harvest proceeds will total 16.5% of Wood Sale Proceeds, representing Maintenance Fees of 8.8%, Rent of 5.5% and Sales Commission of 2.2%.

86. Growers electing to insure their Woodlots (see paragraph 77 of this Ruling) will also be charged an administration charge of 11% of the amount of the premium for each year or part thereof.

87. No further fees are payable to GPL for this Project under Option 3.

Finance

88. To finance all or part of the cost of their 'forestry interest' a Grower can enter into a finance arrangement with Gunns Finance Pty Ltd or, alternatively, borrow from an independent lender external to the Project.

89. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with Gunns Finance Pty Ltd that materially differs from that set out in the documentation provided with the application for this Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

90. A Grower cannot rely on any part of this Ruling if the Application Fees are not paid in full on or before 30 June 2009 by the Grower or, on the Grower's behalf by a lending institution.

Finance offered by Gunns Finance Pty Ltd

91. A Grower can finance the cost of their Application Fees by borrowing that amount from Gunns Finance Pty Ltd (as the Lender). Subject to Gunns Finance Pty Ltd accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

92. The Loan Agreement offered by Gunns Finance Pty Ltd provides the following features:

- Gunns Finance will take security over the Growers Woodlot;
- Loan Terms are available for 12 months, 3, 5, 10 and 15 years;
- a loan Establishment Fee of \$150 plus 0.4% of the loan amount is added to the Loan amount;
- an interest rate of 10.5% p.a. will apply for the first 5 years except for 12 month loans, which are interest free;
- for 10 and 15 year loans, the interest rate will be reviewed at the end of 5 year period and fixed for the following 5 years at 4 percentage points above the ANZ Banking Group Ltd's 5 year swap reference rate;
- an additional 2% interest per annum applies to overdue amounts due and payable;
- monthly repayments of principal and interest are due as per Item 5 of the Loan Schedule and per the Woodlot Project Repayment Schedule and commence in July 2009;
- Growers who enter into these finance arrangements will be required to make equal monthly repayments of the balance over the Term of the Loan; and

- there is no requirement that Growers must have insurance over their Woodlots.

93. At the absolute discretion of Gunns Finance Pty Ltd, the interest rate may be varied within good commercial terms.

94. The Grower agrees to repay the Loan, and pay interest and all other Outstanding Monies to Gunns Finance Pty Ltd. The Grower will pay the 'Repayment Amount' on the 'Repayment Date' of each month during the 'Term' of the 'Loan' as detailed in the Loan Schedule.

95. 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 Gunns Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Appendix 1 – Explanation

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

Structure of the Project

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

97. Under the Constitution of the Project and the other supporting agreements, the holding of a 'forestry interest' in the Project gives each Grower a right to a share in the proceeds of the harvest and thinning of the trees grown on the Project land. That share of proceeds is determined using the number of 'forestry interests' held by a Grower as a proportion of all 'forestry interests' held by 'participants'⁷ in the Project.

Is the Grower carrying on a business?

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

97B. More recently, and in relation to a managed investment scheme similar to that which is the subject of this Ruling, the Full Federal Court in *Hance v. FC of T*; *Hannebery v. FC of T* [2008] FCAFC 196; 2008 ATC 20-085 applied these principles to conclude that 'Growers' in that scheme were carrying on a business of producing almonds (at FCAFC 90; ATC 90).

97C. Application of these principles to the arrangement set out above leads to the conclusion that a Grower (as described in paragraphs 4 to 6 of this Ruling), who stays in the Project until its completion will be carrying on a business of primary production involving afforestation activities.

⁷ The term 'participant' is defined in subsection 394-15(4).

Allowable deductions

Sections 8-5, 12-5, 394-10 and 394-20

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

The '70% DFE rule'

Paragraph 394-10(1)(c) and section 394-35

99. The threshold test for Growers in the Project to be entitled to deductions under subsection 394-10(1) is the '70% DFE rule' in paragraph 394-10(1)(c). Under that rule it must be reasonable to expect that on 30 June 2009, the amount of 'direct forestry expenditure'⁸ under the scheme will be no less than 70% of the amount of payments under the scheme.⁹

100. The amount of all 'direct forestry expenditure' is the amount of the net present value of all 'direct forestry expenditure' that the Responsible Entity, as 'forestry manager'¹⁰ of the Project, has paid or will pay under the scheme (subsection 394-35(2)).

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

102. Both of the above amounts are determined as at 30 June 2009 taking into account:

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

103. Applying all of these requirements to the information provided by the Responsible Entity of the Project, the Commissioner has determined that the Project will satisfy the '70% DFE rule' on 30 June 2009.

⁸ See section 394-45.

⁹ See subsection 394-35(1) and section 394-40.

¹⁰ Defined in section 394-15(2).

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

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

105. The final requirement for deductibility requires all the Project trees to be established within 18 months of 30 June 2009 (see paragraph 394-10(1)(f) and subsection 394-10(4)). The planting timeline provided with the application for this Ruling by the Responsible Entity indicates that all the trees required to be established under the scheme will be planted on the Project land by 31 December 2010.

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

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

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

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

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

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

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

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

Interest on loans to finance the 'forestry interest' of a Grower

Section 8-1

113. Where a Grower borrows money to fund their investment in the Project the deductibility of the interest incurred on the loan monies falls for consideration under the general deduction provisions of section 8-1. If the interest incurred by the Grower is deductible under the first positive limb in subsection 8-1(1) there is no requirement to consider whether it is also deductible under the second positive limb of that provision. Court decisions show that the same basic test applies to both limbs (see *Ronpibon Tin NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431, at CLR 56; ATD 435).

114. Under the first positive limb of subsection 8-1(1) the interest incurred by a Grower will be deductible if it is incurred in gaining or producing a Grower's assessable income and is not excluded by one of the negative limbs in subsection 8-1(2).

The question of whether an outgoing [is] ... incurred in gaining or producing the assessable income is a question of characterisation (*Fletcher & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613, at CLR 17; ATC 4957; ATR 621).

To the extent that ... outgoings of interest ... can properly be characterised as of a kind referred to in the first limb of [section 8-1] they must draw their character from the use of the borrowed funds (*Fletcher*, at CLR 19; ATC 4958; ATR 623).

[T]he characterisation of interest will generally be ascertained by reference to the objective circumstances of the use to which the borrowed funds are put (*Federal Commissioner of Taxation v. Roberts* (1992) 37 FCR 246; 92 ATC 4380; (1992) 23 ATR 494, at FCR 257; ATC 4388; ATR 504).

115. Growers in the Project use the borrowed funds to acquire a 'forestry interest' in a 'forestry managed investment scheme'. The holding of that 'forestry interest' will produce assessable income for a Grower in the form of the proceeds of a full or part disposal of the 'forestry interest' or, as a proportionate share of the harvest and thinning proceeds. The tests of deductibility of interest under the first limb of subsection 8-1(1) are, therefore, met unless one of the exclusions in subsection 8-1(2) apply.

116. For the purposes of this Project, only the capital exclusion in paragraph 8-1(2)(a) is relevant. The use of borrowed funds to purchase a capital asset, such as a 'forestry interest', does not mean that the interest outgoings are on capital account (see *Steele v. Federal Commissioner of Taxation* (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139, at CLR 470; ATC 4249; ATR 148).

Interest [is a] periodic payment for the use, but not the permanent acquisition of a capital item. Therefore, a consideration of the often-cited three matters identified by Dixon J in *Sun Newspapers Ltd v. FC of T ...* assigns interest ... to revenue (*Australian National Hotels Ltd v. Federal Commissioner of Taxation* (1988) 19 FCR 234; 88 ATC 4627; (1988) 19 ATR 1575, at FCR 241; ATC 4633-4634; ATR 1582).

117. Therefore, the capital exclusion in subsection 8-1(2) does not apply to the interest and, subject only to the potential application of the prepayment provisions, a deduction for the interest can be claimed in the year in which it is incurred. (Note: the meaning of 'incurred' is explained in Taxation Ruling TR 97/7.)

Prepayment provisions

Sections 82KZL to 82KZMF

118. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement that will not be wholly done within the same year of income as the year in which the expenditure is incurred. For schemes such as this Project, the main operative provisions are sections 82KZMD and 82KZMF of the ITAA 1936.

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

120. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with Gunns Finance Pty Ltd will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Ruling applies (see paragraphs 91 to 95 of this Ruling) do not require any prepayment of interest over the term of the loan. Accordingly, the prepayment provisions have no application to Growers who enter into those loans.

121. If a Grower chooses to prepay interest on these loans that Grower may request a private ruling on how the prepayment provisions will affect the timing of their interest deduction.

Borrowing costs

Section 25-25

122. A deduction is allowable for expenditure incurred by a Grower in borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income (subsection 25-25(1)).

123. In this Project, the Loan Establishment Fee payable to Gunns Finance Pty Ltd of \$150 plus 0.4% of the amount borrowed, is incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

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

Assessable income, 'CGT events' and the 'forestry interests' of Growers who are 'initial participants'

Sections 6-10, 10-5 and 394-25

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

Subsection 394-25(2)

126. Where a 'CGT event' (other than for a 'CGT event' in respect of a thinning)¹¹ happens to a 'forestry interest' held by a Grower in this Project, subsection 394-25(2) includes an amount in the assessable income of the Grower if:

- the Grower can deduct or has deducted an amount under section 394-10; or
- the Grower would have met the condition immediately above if subsection 394-10(5) had not applied to disallow the deduction(s). Paragraphs 32 to 34 and paragraphs 110 to 112 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to 'CGT events'

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

- no longer holds the 'forestry interest'; or

¹¹ A thinning under this scheme is not a 'CGT event'.

- otherwise – where the Grower continues to hold the ‘forestry interest’, but there is a decrease in the market value of the ‘forestry interest’;

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

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

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

Section 6-5 – amounts received by Growers where the Project trees are thinned

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

131. Thinning amounts received by a Grower in this Project do not arise as a result of a ‘CGT event’ and are not otherwise assessable under Division 394. The receipt of an amount arising from a thinning of the Project trees is a distribution that arises as an incident of the Grower holding a ‘forestry interest’ in the Project. It is an item of ordinary income and is assessable under section 6-5 in the year in which it is derived.

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

131A. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ended 30 June 2009 to 30 June 2033 the Commissioner has applied the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner’s discretion. 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; and

- 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.

131B. 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.

131C. The exercise of the Commissioners discretion under paragraph 35-55(1)(b) for Growers who will stay in the Project until its completion is conditional on the Project being carried out 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

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

Part IVA – general tax avoidance provisions

133. 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).

134. The Gunns Plantations Woodlot Project 2009 will be a 'scheme' and a Grower will obtain a 'tax benefit' from entering into the 'scheme', in the form of tax deductions for the amounts detailed at paragraph 31 of this Ruling that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

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