


PR 2008/65 - Income tax: Great Southern 2009 High Value Timber Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 October 2008*



Product Ruling

Income tax: Great Southern 2009 High Value Timber Project

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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 the scheme is referred to as the scheme, the 'Great Southern 2009 High Value Timber Project', or as simply '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 capitalised terms are specifically defined in the Project agreements.

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 (PDS) or who do not use the Application Form attached to the PDS; or
 - Growers whose Application Fees, including all loan moneys, are not paid in full to Great Southern Managers Australia Limited (GSMAL) by

30 June 2009, either by the Grower and/or on the Grower's behalf by a lending institution.

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 84 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 8 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 8 October 2008 until 30 June 2009, being the closing date for entry into the 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 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. As it is not necessary for an investor to carry on a business to qualify for a deduction under Division 394, this Ruling does not consider whether an initial participant is carrying on a business and thus an enterprise for GST purposes. In this regard, we refer to Draft Goods and Services Tax Ruling GSTR 2008/D1 about registered agricultural managed investment schemes and the income tax test case referred to in that draft ruling. To the extent that the scheme that is the subject of this ruling resembles that in the test case and, if the court finds that a business is carried on by initial participants, investors should be aware that there may be issues relating to GST liability and entitlement to input tax credits that should be considered.

21. Should an 'initial participant' be entitled to an input tax credit in respect of a creditable acquisition (the consideration for which is the Application Price paid by an initial participant), the deduction otherwise available under section 394-10 would be reduced by the amount of the entitlement (subdivision 27-A).

Ruling**Structure of the Project**

22. The Great Southern 2009 High Value Timber Project is a 'forestry managed investment scheme' as defined in subsection 394-15(1). Its purpose is the establishment and tending of Mahogany and Teak 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 83 of this Ruling on or after 8 October 2008 and on or before 30 June 2009.

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.

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 GSMAL (called the 'forestry manager' in Division 394). 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 GSMAL 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 before 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 approximate rates of 1,000 to 1,500 trees per hectare for Mahogany (page 50 of the PDS) and 800 to 1,250 trees per hectare for Teak (page 55 of the PDS). GSMAL 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 GSMAL (sections 8-5 and 394-10).

29. Amounts allowable under section 394-10 do not require a Grower to be carrying on a business of forestry. Therefore, this issue is outside the scope of this Ruling and has not been considered.

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).

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.

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

⁴ See subsection 394-10(4)

⁵ Defined in section 995-1.

Fee	Amount	Income year deductible
Establishment Services fee	\$12,500 See Note (i)	2008-09
Ongoing Services fee	12.5% of the net proceeds of sale	Any year in which this amount is paid See Note (ii)
Rent	2.5% of the net proceeds of sale	Any year in which this amount is paid See Note (ii)

Notes:

- (i) The Application Fee for each Woodlot is \$13,750 inclusive of GST. The amount shown in the table above does not include the GST component of \$1,250. Growers should particularly note the important statements about GST made in paragraphs 20 and 21 of this Ruling.
- (ii) Growers will be notified by GSMAL of the years in which these amounts are paid.

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

32. A deduction for the Establishment Services 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) of the ITAA 1997). 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 premiums and interest on loans to finance the 'forestry interest' of a Grower**Section 8-1**

35. Insurance premiums incurred by a Grower to insure their trees will be deductible under section 8-1. The deduction is allowable in the year in which the insurance premium is incurred. GSMAL will advise the Grower each year of the amount of the insurance.

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 Great Southern Finance Pty Ltd (GSF). 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 fee (comprised of a loan establishment fee and other penalties, costs and expenses that must be paid to GSF under clause 7.1 of the Term of Loan Deed – Term Finance) is a borrowing expense and is deductible under section 25-25.

38. Where the borrowing expense is more than \$100 the deduction must be calculated (subsection 25-25(4)). The amount deductible will depend on the term of the loan.

Loan term	Amount	Year(s) deductible
Less than 5 years	Must be calculated See Note (iii)	The deduction is spread over the period of the loan on a straight line basis from the date the loan begins See Note (iii)
5 years or more	Must be calculated	The deduction is spread over 5 years on a straight line basis from the date the loan begins

Notes:

- (iii) Where the borrowing expense is \$100 or less, a deduction is allowable in the year in which it is incurred (subsection 25-25(6)).

39. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than GSF 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).

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.

Prepayment provisions, non-commercial loss provisions and anti-avoidance provisions

Division 35 of the ITAA 1997 and sections 82KZM, 82KZME, 82KZMF and 82KL and Part IVA of the ITAA 1936

44. Where a Grower is accepted to participate in the Project set out at paragraphs 45 to 83 of this Ruling, the following provisions have application as indicated:

- interest paid by a Grower to GSF does not fall within the scope of sections 82KZM, 82KZME and 82KZMF of the ITAA 1936;
- losses arising from participation in the Project are not within the scope of Division 35 of the ITAA 1997;
- 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:

- the initial Application for a Product Ruling as constituted by documents provided on 3 July 2008;
- additional correspondence received 8 July 2008, 25 July 2008, 29 July 2008, 30 July 2008, 14 August 2008, 18 August 2008, 19 August 2008, 8 September 2008 and 26 September 2008;
- meetings held on 3 July 2008, 22 July 2008 and 27 August 2008;
- Great Southern High Value Timber Project Product Disclosure Statement received on 18 August 2008, including **Application Form**;
- **Constitution** for the Great Southern 2009 High Value Timber Project received 29 July 2008, incorporating the **Land and Management Agreement**, Land and Management Agreement Standard Terms, **Lease**, Lease Standard Terms, **Forest Right Agreement**, and Forest Right Agreement Standard Terms;
- Compliance Plan for Great Southern 2009 High Value Timber Scheme received 29 July 2008;

- Draft Lease between Great Southern HVT Holdings Pty Ltd as lessor and Great Southern Managers Australia Ltd as lessee, received on 3 July 2008;
- Draft **Application for Term Finance** including Term of Loan Deed-Term Finance received 3 July 2008;
- **Right of First Refusal** agreement between Growers and Great Southern Limited received 29 July 2008; and
- 2009 HVT Project Direct Forestry Expenditure Calculation received on 3 July 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 main features of the Great Southern 2009 High Value Timber Project are as follows:

Species of trees to be planted under the scheme	<i>Khaya senegalensis</i> (Mahogany) and <i>Tectona grandis</i> (Teak)
Locations	The Woodlots may be located anywhere in northern Australia which satisfies GSMAL's land selection and evaluation process. The preferred locations are the Douglas Daly River region of the Northern Territory for the planting of Mahogany, and the Cairns-Ingham region of Queensland for the planting of Teak.
Term of the Project	Approximately 20 years and 6 months
Date all trees are due to be planted on scheme land	31 December 2010
Initial number of trees per hectare (approximately)	Mahogany 1,000 to 1,500 stems Teak 800 to 1,250 stems

Thinning and approximate number of trees per hectare at final harvest	<p>Mahogany Non-commercial thinning when trees are approximately 2 years old, reducing the number to 700 per hectare. Commercial thinning will occur at age 8-10 years, leaving 300-400 trees per hectare for final harvest.</p> <p>Teak Commercial thinning when trees are ages 8-10 years and 12-14 years, leaving 200-400 trees per hectare for final harvest.</p>
Number of hectares offered for cultivation	2,000 hectares
Size of each 'forestry interest'	0.5 hectares (0.25 Mahogany and 0.25 Teak)
Minimum allocation of 'forestry interests' per Grower	1
Minimum subscription	No minimum subscription
Initial cost	\$12,500
Ongoing costs	Ongoing Management Fees of 12.5% of the Net Proceeds of Sale, plus A rent or lease fee of 2.5% of the Net Proceeds of Sale.
Other costs	Commencing the 2010-11 income year, Growers will be charged for the cost of all insurance except public liability insurance. Costs of thinning, pruning and sale, to be deducted from the gross proceeds of sale.

49. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Great Southern Managers Australia Limited has been issued with an Australian Financial Service Licence 240787 and will be the Responsible Entity for the Project.

50. The Project will involve commercially growing Mahogany and Teak trees for the purpose of harvesting the timber for sale. The timber is expected to be suitable for furniture and appearance grade timber.

51. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 2,000 hectares, which corresponds to 4,000 'forestry interests' in the Project. Oversubscriptions may be accepted. The 'forestry interests' within this particular Project are referred to as Woodlots. There is no minimum subscription for the Project, and each applicant must apply for at least one 0.5 hectare Woodlot.

52. Application is made by completing the Application Form in the PDS. If the full application moneys are not paid by 30 June 2009, applicants must enter into a 12 months interest free loan arrangement or obtain a principal and interest loan (both with GSF) for the balance by 30 June 2009. The total Application Price per Woodlot, comprising the amount paid by the applicant and/or the amount financed by GSF, must be paid to GSMAL by 30 June 2009. Where the full Application Price per Woodlot is not paid to GSMAL by 30 June 2009, the Grower will not be in the class of entities who can rely on this Product Ruling.

53. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints GSMAL to enter into, on behalf of the Grower, a Land and Management Agreement, a Lease, a Forest Right Agreement, a Sale Agreement, and a Right of First Refusal Deed.

54. For the purposes of this Ruling, an applicant who is accepted to participate in the Project and who execute the Land and Management Agreement on or before 30 June 2009 will have acquired a 'forestry interest' and becomes a Grower in the Great Southern 2009 High Value Timber Project.

55. Great Southern HVT Holdings Pty Ltd has acquired some land that may be used for the Project, and is seeking the remainder. Land utilised by the Project must meet the requirements set out by the Independent Forester at pages 47 to 61 of the PDS.

Constitution

56. The Constitution establishes the Project and operates as a deed binding all Growers and GSMAL. The Constitution sets out the terms and conditions under which GSMAL 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.

57. In order 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 GSMAL, signed by or on behalf of the Applicant, lodged at the registered office of GSMAL and accompanied by payment of the Application Money in a form acceptable to GSMAL.

58. Under clause 5 of the Constitution, GSMAL holds the Application Money on bare trust, and all Application Moneys received from applicants will be deposited into a Project Account.

59. Once GSMAL has accepted the application and all the relevant Project Documents have been executed and remain in force (clause 6.5), the Application Money may be transferred and applied against the fees due to GSMAL (clause 8.1).

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

- the functions, powers and duties of GSMAL (clause 13);
- complaints procedures (clause 14);
- transfer or transmission of Grower's interests (clauses 21 to 24);
- the liability of Growers (clause 25);
- procedures for retirement or removal of GSMAL (clause 26);
- remuneration of GSMAL (clause 27), and costs for which GSMAL shall be reimbursed (clauses 31.2 and 33.1); and
- termination of the project (clauses 36 and 37).

Compliance Plan

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

Plantation lease

62. It is intended that Great Southern HVT Holdings Pty Ltd will acquire all necessary land for the Project, and GSMAL will lease the land from Great Southern HVT Holdings Pty Ltd.

63. Under the terms of a 21 year lease, GSMAL intends to sub-lease the land, which can only be used for the purpose of planting, tending and harvesting a high value timber plantation for commercial wood production. Trees planted on the leased land are the property of GSMAL for the term of the lease (clause 8(p)). Great Southern HVT Holdings Pty Ltd and GSMAL also acknowledge that the trees may belong to third parties to whom a sub-lease has been granted (clause 8(s)).

Sub-lease of land to Growers

64. By no later than 30 September 2010, each Grower will be granted a Lease Interest in their Woodlot(s). A Lease Interest will comprise a Lease, where the Woodlot is located in Western Australia or the Northern Territory, and/or a Forest Rights Agreement where located in Queensland. A Lease Interest may therefore comprise a Lease of the Northern Territory component of their Woodlot, with 0.25 hectares of Mahogany, and a Forest Rights Agreement in respect of the Queensland component, with 0.25 hectares of Teak.

65. Under these agreements, GSMAL will grant to the Grower the right to exclusively possess, occupy, use and enjoy their Woodlots, for the conduct of the Grower's business and to harvest and sell the Mahogany and Teak for a commercial profit.

66. The termination dates for the agreements are the earlier of the date on which harvesting and removal of timber produce from the Grower's Land Area is completed, and:

- Lease – the date the Project is terminated pursuant to the Constitution or the date of payment of the final distribution of the Proceeds Fund. The Lease however will be in two terms, the first for 12 years from commencement, and the second term starting 12 years and one day from commencement. The second term is dependant on receiving a Northern Territory planning approval. It is expected that the second lease term will be 8 years.
- Forest Rights – the date on which harvesting and removal of timber produce is completed *and* the date the Project is terminated pursuant to the Constitution or the date of payment of the final distribution of the Proceeds Fund. It is expected that the term will be 20 years.

Land and Management Agreement

67. Each Grower will enter into a Land and Management Agreement (LMA) with GSMAL, to be executed on or before 30 June 2009. Key elements of this agreement are:

- within 15 months of Commencement Date (that is, by no later than 30 September 2010), GSMAL must grant the 'Land Interest' to Growers (which includes the execution of the Lease and Forest Rights Agreement over the Growers Woodlot(s)), determine the land area and physical location of each Grower's Woodlots, and complete the schedules to the Lease Interests (clause 2);
- the Grower appoints GSMAL to perform and complete the Establishment Services on or before 31 December 2010 (clause 3);

- the Grower appoints GSMAL to perform the Ongoing Services (commencing no later than 1 January 2011 until termination of the Project (clause 3);
- the trees are to be harvested not later than 30 June 2029 (clause 7);
- GSMAL will be irrevocably appointed as the Grower's agent for the purpose of negotiating and making sales of Timber Produce (clause 9); and
- the Gross Proceeds of Sale must be paid into the Proceeds Fund, out of which will be paid the costs of Commercial Thinning, Non-commercial thinning, Pruning, and Sale (clause 11).

68. The Establishment Services to be provided by GSMAL include, amongst other things:

- to establish a Mahogany and Teak plantation according to good silvicultural and forestry practices;
- ripping and mounding;
- supply of plants;
- fertilising and spraying of the Woodlot; and
- planting of seedlings or trees on the Woodlot.

69. GSMAL will commence the provision of the Ongoing Services after the completion of the Establishment Services, and shall continue to provide the Ongoing Services until the termination of the Agreement.

70. The Ongoing Services include:

- managing and maintaining the plantation according to good silvicultural and forestry practices;
- cultivating, tending, culling, fertilising, replanting, spraying and otherwise caring for the trees;
- pruning and thinning;
- provide to Growers a report on the plantations 12 months after they have been established; and
- organising and arranging for trees to be clearfelled when they reach harvest maturity.

Distribution of the proceeds of sale

71. GSMAL will pay all proceeds from the sale of timber and any insurance proceeds into the Proceeds Fund. Clause 32 of the Constitution sets out the arrangements relating to distributions from the Proceeds Fund. GSMAL will distribute the Proceeds Fund among the Growers in accordance with each Grower's proportional interest in those proceeds.

Fees

72. Under the terms of the LMA, the Sub-lease, and the Forest Rights Agreement, a Grower will make payments as described below on a per 'forestry interest' basis.

Fees payable under the LMA

73. The \$12,500 fee per Woodlot to be paid by each Grower on application, described as the Application Price in the PDS and as Remuneration in the LMA, is for the provision of the Establishment Services in the Application Period.

74. Following the income year in which the application is made, monies shall be paid to GSMAL for providing the Ongoing Services, calculated as 12.5% of the Net Proceeds of Sale.

Fees payable under the (sub) Lease and Forest Rights Agreement

75. For the term of the Project, an amount, described as Rent in the Lease and a Fee in the Forest Rights Agreement, must be paid calculated as 2.5% of Net Proceeds of Sale.

76. Commencing the year these agreements are executed, insurance premiums with respect to the Grower's Land Area must be paid annually.

Finance offered by Great Southern Finance Pty Ltd

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

78. Only the finance arrangement set out below is covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with GSF 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 other than GSF may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

79. A Grower cannot rely on any part of this Ruling if the Application Price (defined in the PDS) is not paid in full on or before 30 June 2009 by the Grower or, on the Grower's behalf, by a lending institution.

80. Subject to GSF accepting the Grower's application, the Grower will be bound by the terms and conditions of the PDS and the Application for Term Finance. Two categories of finance are available from GSF.

12 months interest free terms

81. The conditions of these terms are set out in pages 73 to 82 of the PDS, and include:

- the maximum that can be borrowed is \$12,500 per Woodlot;
- the amount borrowed must be repaid in 12 equal monthly repayments, with the first repayment on or before 15 July 2009; and
- no interest or other fees will be applicable, unless the loan or part thereof is not repaid.

Principal and interest loan

82. The conditions include:

- the maximum per Woodlot that can be borrowed;
- principal and interest loans are available with repayment terms of 2 years to 15 years;
- Growers are required to make equal monthly repayments of principal and interest over the term of the loan, commencing on or about 31 July 2009;
- interest will be fixed for the term of the loan, and the rate will be set with reference to a commercial margin over the inter-bank swap rate for that term;
- the borrower must pay a fee which includes a loan establishment fee of 0.5% of the amount borrowed (the loan establishment fee may be reduced for staff and authorised representatives of GSMAL or its associates, large participants/participant groups, or repeat customers of GSMAL or its associates);
- the Woodlot(s) must be insured to 'Gold' level;
- insurance or timber proceeds must be applied to any moneys payable but unpaid under the loan; and
- the Grower's Woodlot(s) will be held as security for the loan.

83. 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 GSF, 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

84. In return for payment of the Establishment Services Fee and the other fees and expenses required under the Project agreements 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)).

85. 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 sales from thinning or harvest 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.

Allowable deductions

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

86. 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

87. 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

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

⁸ See section 394-45.

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

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

89. 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)).

90. 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).

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

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

92. 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 GSMAL's role in other managed investment schemes.

93. 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 GSMAL indicates that all the trees required to be established under the scheme will be planted on the Project land by 31 December 2010.

94. Accordingly, subject to the qualifications set out below, amounts paid by Growers to GSMAL 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)).

¹⁰ Defined in section 394-15(2).

95. 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 GSF 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 section 394-10(1)

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

97. The first of these situations will occur if GSMAL fails to establish the trees on the Project land within 18 months. Where this occurs GSMAL 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).

98. 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 Services fee (see subsection 394-10(5)).

99. 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) of the ITAA 1997).

100. 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

101. 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 at 65; (1949) 8 ATD 431).

102. 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 (Fletcher)* (1991) 173 CLR 1; (1991) 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; (1992) 92 ATC 4380; (1992) 23 ATR 494, at FCR 257; ATC 4388; ATR 504).

103. 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 thinning and harvest 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.

104. 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; (1999) 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; (1988) 88 ATC 4627; (1988) 19 ATR 1575, at FCR 241; ATC 4633-4634; ATR 1582).

105. 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

106. 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 section 82KZMF of the ITAA 1936.

107. However, subsection 394-10(7) of the ITAA 1997 specifically provides that sections 82KZMD and section 82KZMF of the ITAA 1936 do not affect the timing of amounts deductible under section 394-10 of the ITAA 1997.

108. Accordingly, under the scheme to which this Product Ruling applies, only deductions for interest payable under a loan with Great Southern Finance Pty Ltd will potentially fall within the prepayment provisions. However, the conditions applying to the loans to which this Ruling applies (see paragraphs 81 to 83 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.

109. 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

110. 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)).

111. In this Project the fee (including the loan establishment fee) payable to GSF 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.

112. Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)). Where the amount exceeds \$100, 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***

113. 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)

114. 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 98 to 100 of this Ruling explain when deductions will be disallowed under subsection 394-10(5).

Market value rule applies to 'CGT events'

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

- no longer holds the 'forestry interest'; or
- 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.

116. 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)).

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

117. 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

118. 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)).

119. 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 82KL – recouped expenditure

120. 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 of the ITAA 1997.

Part IVA – general tax avoidance provisions

121. 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).

122. The Great Southern 2009 High Value Timber Project 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 paragraphs 28 and 35 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.

123. 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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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 98/22;
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Subject references:

- carrying on a business
- DFE
- direct forestry expenditure
- forestry interest
- forestry MIS
- interest expenses
- managed investment schemes
- market value substitution rule
- payments under the scheme
- producing assessable income
- product rulings
- reasonable expectation
- tax avoidance
- taxation administration
- 4 year holding period
- 70 per cent DFE rule

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZLA
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- ITAA 1936 82KZMB
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NO: 2008/11110

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ timber