


PR 2004/114 - Income tax: Great Southern Plantations 2005 Project - (Pre 30 June Growers)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *15 December 2004*



Product Ruling

Income tax: Great Southern Plantations 2005 Project – (Pre 30 June Growers)

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Potential participants may wish to refer to the Tax Office website at www.ato.gov.au or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Great Southern Plantations 2005 Project', or just simply as 'the Project'.

Tax law(s)

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

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

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as Pre 30 June Growers or simply as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it. Growers who elect to market their own produce are also excluded from the class of persons to whom this Ruling applies (see paragraphs 40 and 49).

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 15 December 2004, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 28 September 2004;
- Draft PDS for the Great Southern Plantations 2005 Project, to be issued by Great Southern Managers Australia Ltd (GSMAL), received 1 October 2004;
- Draft **Constitution** of the Great Southern Plantations 2005 Scheme, dated 20 September 2004;
- Draft **Land and Management Agreement** between GSMAL (as both the 'Landholder' and 'Responsible Entity') and the Grower, dated 11 September 2004;
- Draft **Lease or Forest Right Agreement** between GSMAL (as both the 'Landholder' and 'Responsible Entity') and the Grower, dated 11 September 2004;

- Draft Compliance Plan for Great Southern Plantations 2005 Project dated 21 September 2004;
- Plantation Management Agreement between GSMAL and Great Southern Plantations Ltd (GSPL), dated 8 February 2001;
- Variation to Plantation Management Agreement between GSMAL and Great Southern Plantations Ltd (GSPL), undated;
- **Loan Deed** between Great Southern Finance Pty Ltd (as the 'Lender') and the Borrower;
- Proforma Lease between GSMAL and Great Southern Property Managers Ltd (as the 'Landholder'); and
- Additional correspondence between the Tax Office and the Applicant dated 22 October 2004, 25 October 2004, 2 November 2004 and 9 December 2004.

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

15. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

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

Overview

17. The salient features of the Great Southern Plantations 2005 Project are as follows:

Location	Western Australia, Victoria, South Australia, Queensland or such other areas of Australia deemed suitable for the commercial growing of Eucalypts.
Type of business each participant is carrying on	Commercial growing of Eucalypt species for the production of short fibre hardwood woodchips for use in the paper industry.
Number of hectares offered for cultivation	This PDS provides for 5,000 hectares to be planted, however, oversubscriptions may be accepted.
Size of each Woodlot	0.33 hectares
Number of trees per hectare	Average of 1,000 per hectare

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Term of the Project	Approximately 11 years
Initial cost	\$2,970 or \$3,300
Initial cost per hectare	\$9,000 or \$10,000
Ongoing costs	Growers are required to pay 3.3% of net harvest proceeds as management fees and 2.75% of net harvest proceeds as rent/lease fees.
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance.

18. Under this PDS, GSMAL proposes to offer 15,000 interests called 'Woodlots' of 0.33 hectares. The Project is registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is Great Southern Managers Australia Ltd (GSMAL).

19. Growers who have their 'Applications' accepted on or before 30 June 2005 will enter the Project as Pre 30 June Growers. **This Ruling only applies in respect of these Pre 30 June Growers. Note that a separate Product Ruling has been issued for Growers who enter into the Project during the period 1 July 2005 to 30 June 2006.**

20. There is no minimum amount that must be raised under the PDS for this Project. The majority of the land for the Project has been, or will be, purchased by Great Southern Property Managers Ltd (GSPML), a wholly owned subsidiary of GSMAL. Additional land may be leased by GSPML from third parties. GSMAL will lease the land from GSPML. GSMAL has the right to accept oversubscriptions.

21. The Growers will enter into a contract with GSMAL to have suitable Eucalyptus seedlings planted on their Woodlot for the purpose of eventual felling and sale in approximately eleven years. GSMAL will establish and cultivate the trees and be responsible for harvesting, processing and selling the timber. Unless the Grower elects to take possession of their timber, GSMAL will arrange the marketing and sale of the forest produce.

22. Upon application, Growers will execute a Power of Attorney enabling GSMAL to act on their behalf as required. Each Grower is provided with an ownership certificate and a copy of the plantation grid map from which their land and trees can be identified.

23. Growers in this Project who initially invested in the Great Southern Plantations 1994 Project and whose names are shown on the Register of Growers upon harvest of that Project will be entitled to a discount of 10% on the cost of their application fees for Establishment Services for this Project.

Constitution

24. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which GSMAL agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 29 of the Constitution, the Responsible Entity will keep a register of Growers.

25. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Application Fund in the name of the Responsible Entity. The application moneys will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clauses 7 and 8 of the Constitution).

Compliance plan

26. As required by the Corporations Law, a Compliance Plan has been adopted by GSMAL for the Project. The purpose of the Compliance Plan 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.

Land and Management Agreement

27. Growers participating in the arrangement will enter into a Land and Management Agreement (LMA) between GSMAL and the Grower.

28. Under the Land and Management Agreement, each Grower appoints GSMAL to perform services under the agreement from the Commencement Date, being the date of execution of the agreement. GSMAL will supervise and manage all silvicultural activities on behalf of the Grower. The services to be performed are specified in the clause 1 definitions of 'Establishment Services', 'Planting Services' and 'Services'.

29. The Establishment Services to be performed during the Establishment Period, being a period of 12 months from the Commencement Date, are as follows:

- (a) ripping and mounding the Woodlot as necessary from the Commencement Date;
- (b) otherwise preparing the Woodlot for planting as necessary from the Commencement Date;
- (c) procurement of sufficient Eucalyptus seedlings or trees of appropriate size as is reasonably required to complete the Planting Services;

- (d) fertilising the Woodlot as necessary from the Commencement Date;
- (e) spraying the Woodlot as necessary from the Commencement Date;
- (f) maintaining the Woodlot according to good silvicultural and forestry practices; and
- (g) the Planting Services.

Lease or Forest Right Agreement

30. Growers participating in the Project will, pursuant to the terms of the Land and Management Agreement, be granted an interest in land by GSMAL in the form of a sub-lease or forest right to use their Woodlot for the purpose of conducting their afforestation business.

31. Growers with Woodlots in any State or Territory other than Queensland will enter into a Lease Agreement whereas Growers with Woodlots in Queensland will enter into a Forest Right Agreement on the same terms. Where this Ruling uses the terms 'Lease' and 'Lessor' it is intended to also include the respective terms 'Forest Right' and 'Grantor' in the same context.

32. The Lease or Forest Right Agreement (LFR) gives the Grower a lease over an identifiable area of land for approximately 11 years when the final distribution of the sale proceeds is made to the Grower or until the Project is terminated.

33. Growers will have the opportunity of entering into new arrangement(s) (as appropriate) with the Responsible Entity at the expiration of the first Land and Management Agreement in respect of a second crop. It is intended that the new arrangement(s) would be on terms and conditions to be set by the Responsible Entity at the time. This Ruling does not apply to the second rotation.

34. Each Grower must pay Rent to the Lessor in an amount specified in clause 3 of the Lease or Forest Right Agreement. Payment of Rent is deferred until the year the harvest proceeds are received.

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

- will not use, or permit to be used, the Woodlot for a purpose other than that of commercial silviculture;
- will not use, or permit to be used, the Woodlot for residential, recreational or tourist purposes;
- must pay annual insurance premiums;
- shall keep the Woodlot in good and substantial repair; and
- must not install upon or remove anything from the Woodlot.

Fees

36. The fees payable under the Land and Management Agreement on a per Woodlot basis are as follows:

- \$3,300 payable on Application for Establishment Services, or for Growers in this Project who initially invested in the Great Southern Plantations 1994 Project and whose names are shown on the Register of Growers upon harvest of that Project, \$2,970 is payable on Application for Establishment Services;
- at harvest, GSMAL is entitled to 3.3% of the Net Proceeds of Sale of harvest in consideration for meeting the ongoing management and maintenance expenses from completion of the Establishment Services until harvest; and
- at harvest, GSMAL is entitled to 2.75% of the Net Proceeds of Sale of harvest for Rent during the term of the agreement.

37. GSMAL will use its best endeavours to arrange insurance of the Woodlot on behalf of the Grower to cover against fire and other usual risks.

Planting

38. GSMAL will be responsible for planting Eucalyptus seedlings on the Woodlots. The species to be planted will generally be *Eucalyptus globulus* for Woodlots located in Western Australia, South Australia and Victoria and *Eucalyptus grandis* and *Eucalyptus dunnii* for Woodlots located in Queensland. A sufficient number of trees will be planted which would reasonably be expected to meet the projected timber production.

39. GSMAL must complete all Establishment Services, including the Planting Services within 12 months of the Grower's Commencement Date. GSMAL will then maintain the trees in accordance with good silvicultural practice and will furnish reports to the Grower regarding the progress of the trees.

Harvesting and sale

40. Growers may elect, within 6 years of the Commencement Date, to become an 'Electing Grower' (clause 8.1 of the LMA) and take their own Collectable Produce by giving written notice to GSMAL. This Ruling does not apply to Electing Growers.

41. GSMAL will sell the forest produce on behalf of the 'Non-Electing Growers' for the maximum practicable price (clause 9.1 of the LMA). At all times the Grower has full right, title and interest in the Forest Produce and the right to have the Forest Produce sold for their benefit (clause 11.3 of the LFR).

42. Harvesting is to take place when the forest produce equals or exceeds 250 cubic metres per hectare or no later than 11 years from the Commencement Date unless GSMAL believes that it would be in the best interests of the Growers for harvesting to be deferred and the Growers resolve to do so by ordinary resolution (clause 7 of the LMA).

43. Growers will share the Gross Proceeds of Sale on a proportionate basis following the payment of felling costs, costs of sale, costs of chipping (if applicable), and any amounts due and payable by the relevant Grower (clause 11 of the LMA).

44. GSMAL will ensure that the Gross Proceeds of Sale are paid into the Proceeds Fund trust bank account. The Growers' proportional share of the costs of felling and costs of sale, and, if applicable, the costs of chipping, will be paid from the Gross Proceeds of Sale to GSMAL, or the relevant contractor. GSMAL will receive from the Proceeds Funds an amount equal to 2.75% of the Net Proceeds of Sale, as rent, and another amount equal to 3.3%, as remuneration for the services provided following completion of the Establishment Services. The balance of the Net Proceeds of Sale will be distributed to the Non-Electing Growers on a proportionate basis. The terms 'Proceeds Fund' and 'Grower's Proportional Share' are defined in clause 1 of the LMA.

Finance

45. Growers can fund their participation in the Project themselves, borrow from Great Southern Finance Pty Ltd (a lender associated with GSMAL) or borrow from an independent lender.

46. Finance is available under the following arrangements. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers:

Option A – Interest Free Finance

- equal monthly principal instalments over a period not to exceed 2 years;
- instalments paid by direct debit commencing on 15 July 2005;
- GST is payable on execution of the Land and Management Agreement (\$300 or \$270 per Woodlot); and
- No interest applicable.

Option B – Principal and Interest Finance – Minimum of \$15,000

The terms of the principal and interest finance arrangements provided by Great Southern Finance Pty Ltd include options of loans for a minimum of 2 years up to a maximum of 10 year terms as follows:

Term	2, 3, 4, 5, 7 or 10 years	
Interest Rates (fixed for term of loan)	2 year	10.0%pa
	3 year	10.0%pa
	4 year	10.5%pa
	5 year	10.5%pa
	7 year	11.0%pa
	10 year	11.5%pa
Interest only periods	2 year	1 years interest only
	3 year	1 years interest only
	4 year	2 years interest only
	5 year	2 years interest only
	7 year	3 years interest only
	10 year	3 years interest only

A discount of up to a maximum of 2% off the standard rates may be offered to:

- staff and authorised representatives of the Great Southern group;
- large participants/participant groups; and
- repeat participants in Great Southern projects.

For loans under Option B, the following will apply:

- GST is payable on execution of the Land and Management Agreement (\$300 or \$270 per Woodlot);
- instalments paid by direct debit commencing on 15 July 2005;
- application fee of 1% of the loan advance (no GST applicable);
- legal administration fee of \$250 (no GST applicable); and
- security taken over Lease/Forest Right Agreement.

The application fee and the legal administration fee for loans under Option B may however be discounted or waived for:

- staff and authorised representatives of the Great Southern group;
- large participants/participant groups; and
- repeat participants in Great Southern projects.

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

- entities associated with the Project, other than Great Southern Finance Pty Ltd, are involved in the provision of finance for the Project;
- 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' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Application of this Ruling

48. This Ruling applies only to Growers who are accepted to participate in the Project by 30 June 2005 (Pre 30 June Growers), where the Grower has executed a Land and Management Agreement on or before that date.

49. The Grower's participation in the Project must constitute the carrying on of a business of primary production (See Explanation at paragraphs 60 to 72). A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to Growers who elect to market timber produce from their Woodlots (Electing Growers).

The Simplified Tax System (STS)

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

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

Qualification

51. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'**Assessable income****Section 6-5**

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

53. The Grower recognises ordinary income from carrying on the business of afforestation at the time that income is derived.

Deductions for management fees and interest**Section 8-1**

54. A Pre 30 June Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses on a per Woodlot basis:

Fee Type	ITAA 1997 Section	Year Ending 30 June 2005	Year Ending 30 June 2006	Year Ending 30 June 2007
Establishment Services Fee or Discounted Establishment Services Fee	8-1	\$3,300 or \$2,970 See Notes (i) & (ii)		
Interest	8-1	As incurred See Note (iii)	As incurred See Note (iii)	As incurred See Note (iii)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27. See Example at paragraph 105.
- (ii) Expenditure for Establishment Services is expenditure for 'seasonally dependent agronomic activities' and is deductible in full in the income year in which it is incurred (see paragraphs 85 to 89). Accordingly, \$3,300 is deductible, or for Growers in this Project who initially invested in the Great Southern Plantations 1994 Project and whose names are shown on the Register of Growers upon harvest of that Project, \$2,970 is deductible.
- (iii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Great Southern Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However, all Growers including those who finance their participation in the Project other than with Great Southern Finance Pty Ltd, should read carefully the discussion of the prepayment rules in paragraphs 77 to 84 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Tax outcomes for Growers who are 'STS taxpayers'**Assessable income*****Section 6-5 and section 328-105***

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

56. The Grower recognises ordinary income from carrying on the business of afforestation at the time the income is received (paragraph 328-105(1)(a)).

Deductions for management fees and Interest***Section 8-1 and section 328-105***

57. A Pre 30 June Grower who is an 'STS taxpayer' may claim tax deductions for the revenue expenses in the following Table on a per Woodlot basis. However, if for any reason, an amount shown in the Table below is not fully paid in the year in which it is incurred by a

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

Fee Type	ITAA 1997 Section	Year Ending 30 June 2005	Year Ending 30 June 2006	Year Ending 30 June 2007
Establishment Services Fee or Discounted Establishment Services Fee	8-1 & 328-105	\$3,300 or \$2,970 See Notes (iv) & (v)		
Interest	8-1 & 328-105	When paid See Note (vi)	When paid See Note (vi)	When paid See Note (vi)

Notes:

- (iv) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27. See Example at paragraph 105.
- (v) Expenditure for Establishment Services is expenditure for 'seasonally dependent agronomic activities' and is deductible in full in the income year in which it is paid (see paragraphs 85 to 89). Accordingly, \$3,300 is deductible, or for Growers in this Project who initially invested in the Great Southern Plantations 1994 Project and whose names are shown on the Register of Growers upon harvest of that Project, \$2,970 is deductible.
- (vi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Great Southern Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Great Southern Finance Pty Ltd, should read carefully the discussion of the prepayment rules in paragraphs 77 to 84 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Tax outcomes that apply to all Growers

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

Section 35-55 – exercise of Commissioner’s discretion

58. A pre 30 June Grower who is an individual accepted into the Project in the year ended 30 June 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for Growers for the income years ending **30 June 2005 to 30 June 2016**. This conditional exercise of the discretion will allow those losses to be offset against the Grower’s other assessable income in the income year in which the losses arise.

Section 82KL and Part IVA

59. For a Grower who commences participation in the 2005 Project and incurs expenditure as required by the Land and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanation

Is the Grower carrying on a business?

60. For the amounts set out in the Tables above to constitute allowable deductions, the Grower’s afforestation activities as a participant in the Great Southern Plantations 2005 Project must amount to the carrying on of a business of primary production.

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

62. For schemes such as those of the Great Southern Plantations 2005 Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower’s activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such

as *Commission of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

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

64. In this Project, each Grower enters into a Lease or Forest Right Agreement. Under the agreement each individual Grower will have rights over a specific and identifiable area of land. The agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the agreement, the Grower must use the land in question for the purpose of carrying out afforestation activities, and for no other purpose. The agreement allows Great Southern Managers Australia Ltd, the Landholder and the Responsible Entity, to come onto the land to carry out their obligations.

65. Each Grower also enters into a Land and Management Agreement. Under the agreement, the Responsible Entity is engaged by the Grower to establish and maintain a Woodlot on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Woodlot on the Grower's behalf.

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

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

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

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

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

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

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

The Simplified Tax System

Division 328

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

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

Deductibility of management fees and lease fees

Section 8-1

75. Consideration of whether the initial management fees and lease fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;

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

76. The fee for Establishment Services is associated with the afforestation activities that will relate to the gaining of income from the Grower's business of afforestation (see above), and hence has a sufficient connection to the operations by which income (from the harvesting and sale of wood produce) is to be gained from this business. It will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMF

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

78. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME, 82KZMF and 82KZMG are relevant. Subject to section 82KZMG, if the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1) (see paragraph 83). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

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

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

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

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

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

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

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

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

Section 82KZMG

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

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

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

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

- it must be an agreement for planting and tending trees for felling;
- be an agreement where the taxpayer does not have day to day control over the operations arising out of the agreement. (A right to be consulted or to give directions does not equate to day to day control for the purposes of this requirement); and
- either:
 - (i) there must be more than one participant in the agreement in the same capacity as the taxpayer who incurs the expenditure; or
 - (ii) the manager manages, arranges or promotes the agreement, or an associate of the manager, manages, arranges or promotes similar agreements.

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

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

Application of the prepayment provisions to this Project

90. Under the Land and Management Agreement, a Grower incurs a fee for Establishment Services of \$3,300 or \$2,970 per Woodlot. This fee consists of expenditure for 'seasonally dependent agronomic activities'. As the requirements of section 82KZMG have been met, a deduction is allowable in the same income year as the expenditure is incurred under the Land and Management Agreement for 'seasonally dependent agronomic activities'.

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

Interest deductibility

(i) Growers who use Great Southern Finance Pty Ltd as the finance provider

92. Some Growers may finance their participation in the Project through a loan facility with Great Southern Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

93. The interest incurred by these Growers will be in respect of a loan to finance the Project business operations of growing trees and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

94. In the absence of any application of the prepayment provisions (see paragraphs 77 to 84), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

95. If the Grower is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

96. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Grower. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid, or is paid for the Grower.

(ii) Growers who DO NOT use Great Southern Finance Pty Ltd as the finance provider

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

98. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure', any tax deduction that is allowable will be subject to the relevant prepayments provisions of the ITAA 1936 (see paragraphs 77 to 84).

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

Section 35-55 – exercise of Commissioner's discretion

99. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for Growers for the income years **30 June 2005 to 30 June 2016**, the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14, *Income tax: Division 35 – non-commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2005 up to and including 30 June 2016:

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

100. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling, a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL

101. The operation of section 82KL 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. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

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

103. The Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 54 and 57 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Example – entitlement to GST input tax credits

105. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2002, Susan receives a valid

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

Management fee for period 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 2003, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

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

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Commissioner of Taxation

15 December 2004

<i>Previous draft:</i>	- management fees
Not previously issued in draft form	- non-commercial business activities
<i>Related Rulings/Determinations:</i>	- producing assessable income
IT 360; TR 92/1; TR 92/20;	- product rulings
TR 97/11; TR 97/16; TR 98/22;	- public rulings
TR 2000/8; TR 2001/14;	- seasonally dependent agronomic activity
TD 93/34; PR 1999/95	- tax avoidance
<i>Subject references:</i>	- tax benefits under tax avoidance schemes
- advance deductions and expenses for certain forestry expenditure	- tax shelters
- carrying on a business	- tax shelters project
- commencement of business	- taxation administration
- fee expenses	<i>Legislative references:</i>
- forestry agreement	- ITAA 1936 82KL
- interest expenses	- ITAA 1936 Pt III Div 3 Subdiv H
	- ITAA 1936 82KZL

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- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
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- ITAA 1936 82KZMG(4)
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- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 Subdiv 328-F
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- Copyright Act 1968

Case references:

- Commission of Taxation v. Lau
(1984) 6 FCR 202; 84 ATC
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NO: 2004/17430
ISSN: 1441-1172