



The Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Department of the Senate  
PO Box 6100  
Parliament House Canberra ACT 2600

Dear Dr Batge

**Australian Taxation Office (ATO) submission – inquiry into agribusiness managed investment schemes**

Thank you for your letter dated 3 June 2009 inviting the ATO to make a submission to the Committee's inquiry into agribusiness managed investment schemes (MIS).

The Committee's 12 terms of reference indicate that tax is only one of many factors relevant to the inquiry. Reducing tax is never, on its own, a basis for sound commercial investment decisions.

The ATO is responsible for the administration of the tax laws, including their application to MIS arrangements.

By way of background, the issue of MIS arrangements has had a chequered past. These arrangements formed the basis of many of the mass marketed investment schemes of the late 1990s and early 2000s. These have been the subject of a number of reviews by parliamentary committees, including by the Senate Economics References Committee and the Joint Committee of Public Accounts and Audit, together with questions on a number of occasions at Senate Estimates hearings.

The former Government in 2007 legislated for a separate taxation regime providing upfront deductions for investors in afforestation arrangements, leaving the other arrangements to be considered under the ordinary tax provisions of the law.

We have often been asked the question about whether relatively high up-front fees was a ground to reject a portion of the taxpayers' expenditure under the ordinary tax provisions. Our response was that absent grossly excessive fees, there is authority such as *Cecil Bros Pty Ltd. v FC of T* (1964) 111 CLR 430 precluding a challenge on the deductibility of the fees on those grounds. As a general rule: "it is not for the Court or Commissioner to say how much a taxpayer ought to spend in obtaining his income". The decision whether to pay a high fee is essentially a commercial decision for the taxpayer.

However, in a number of cases, in negotiation with the marketers of these arrangements, we were able to reduce very high up-front fees prior to issuing a product ruling and in the others we lifted the bar on what was legally necessary to provide a sound basis for deductibility.

More recently, by 2006 developments in corporations and tax law cases prompted the ATO to reconsider its view on the deductibility (on ground broader than the high level of fees) of investments in registered agribusiness MIS. The ATO's reconsidered view was that the amounts paid by investors were capital and therefore not deductible. However, as the matter was not free from doubt, the ATO sought to minimise impacts on the agribusiness MIS sector while seeking to test the matter through the courts. The Court found that the expenses were not capital in nature and were allowable deductions incurred in carrying on business by participants in agribusiness MIS. The Full Federal Court on 19 December 2008 handed down its decision in the MIS test case which we funded (*Hance & Hannebery v FC of T*).

We do not issue product rulings covering features involving round robin or non-recourse financing arrangements such as those that existed and were disallowed by the courts in mass marketed investment scheme cases such as *Howland-Rose & Ors v FV of T* (Budplan case) and *Vincent v Commissioner of Taxation*. In 2005 we issued finance guidelines to address concerns we had with certain finance arrangements presented to us. These guidelines assisted managers to structure their investor financing arrangements so that they are within the requirements of the tax law and to reduce the likelihood of the general anti-avoidance provisions applying. The guidelines met some criticism from the industry.

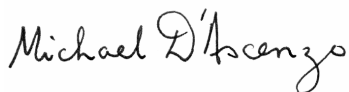
We have at all times highlighted two important conditions when issuing product rulings:

1. that we only provide advice on the tax consequences and not on the commercial viability of these schemes; and
2. that our advice is conditional on all relevant facts having been provided to us and on the schemes being implemented in accordance with what had been provided to us.

We kept Treasury informed about what we were seeing on the ground. Subsequently, the former Government announced in May 2006 that it would consult on proposed new taxation arrangements for investments in forestry MIS. More recently, the Government released on 29 May 2009 the findings of a review of non-forestry agricultural MIS undertaken by Treasury. The review concluded, among other things, that the tax treatment of MIS could be considered sub-optimal when taking an economic substance approach to taxation. However, the review also noted that there are a range of other tax incentives available to primary producers (and not MIS investors).

I have enclosed some further information about our areas of responsibility as they relate to this inquiry.

I trust this information will assist the Committee and am happy to make my officers available to provide further assistance as required.



Michael D'Ascenzo  
Commissioner of Taxation

26 June 2009

**AUSTRALIAN TAXATION OFFICE (ATO) SUBMISSION**  
**INQUIRY INTO AGRIBUSINESS MANAGED INVESTMENT SCHEMES**

1. The role of rulings system

The Commissioner issues private and public rulings in order to provide certainty as to his opinion of how the tax law applies. A private ruling is a way for a taxpayer to find out the Commissioner's view about how the laws apply to their particular circumstances. A public ruling enables the Commissioner to rule on how the law applies generally or to a class of taxpayers or arrangements.

In response to the spread of mass marketed schemes, product rulings were introduced in 1998 to offer an avenue for potential investors to satisfy themselves about the bona fides of tax benefits claimed in the marketing of so called tax-effective investments. Product rulings are a form of public ruling.

The tax consequences ruled upon in MIS product rulings include the availability of upfront business deductions and consideration of timing issues such as the prepaid expense rules and the non-commercial loss rules.

Product rulings are not issued to assist a promoter or arranger to market a project, but rather to provide assistance to both potential participants and their advisors about the application of the tax laws to their arrangements. Rulings only bind the Commissioner where the arrangement is implemented in accordance with that described in the relevant ruling.

The ATO warns potential participants to closely examine the overall financial merits of an investment product before making a decision on whether or not to invest.

We expressly caution potential participants that the ATO does not sanction or guarantee any product as an investment. We do not give any assurance that the product is commercially viable, that the projected returns will be achieved or that fees charged by managers or projected returns are reasonable.

An example of this caution is the following extract from the ATO's Product Ruling template, published with each product ruling:

*While a Product Ruling provides entities covered by the Product Ruling with certainty as to the tax consequences of participating in the scheme described in the Product Ruling, the Product Ruling provides no assurance that:*

- *the scheme is commercially viable;*
- *the fees, charges and other costs are reasonable or they represent industry norms; or*
- *the projected returns will be achieved or are reasonably based.*

*Potential participating entities must form their own view about the commercial and financial viability of the scheme.*

In the early period of the product ruling system we became aware of some instances where the ATO view expressed in product rulings was selectively quoted in marketing materials. We subsequently tightened the terms of use of product rulings to prevent this from recurring.

We have attached some recent examples (published on websites) of references in marketing materials about the product rulings which is consistent with the role that the ATO sought to achieve. The introduction of the promoter penalty laws in 2006 may also have had a positive effect on the references to tax implications in marketing materials.

Beyond specific advice on product ruling arrangements, we conduct an annual awareness campaign targeted at potential investors in schemes, involving widespread distribution of our *'Don't take the bait'* brochure and advice to people to *'Investigate before investing'*<sup>1</sup>.

When a promoter applies for a product ruling, full disclosure of the arrangement and accompanying documentation is required so that a proper assessment of the tax consequences can be made.

The terms of use that applicants for product rulings enter into require them to advise the ATO of any material differences in implementation of the arrangement ruled upon. If the scheme is carried out in a way that is materially different to that described in the product ruling, then the deductibility of expenses will depend upon the application of the tax laws to the circumstances of the arrangement as implemented. In these circumstances, the taxpayer may seek a private binding ruling to clarify the deductibility of expenses incurred.

Additionally, the promoter penalty laws introduced in 2006 may apply to impose sanctions on promoters that implement a scheme in a manner materially different to the arrangement in the relevant product ruling.

## 2. The non-commercial loss provisions

Although we do not guarantee the commercial viability of any product as an investment, we are concerned about the commerciality of MIS where this is relevant to the taxation consequences for participating taxpayers. The non-commercial loss provisions, which have applied from 1 July 2000 and are specifically addressed in product rulings, require the ATO to consider commercial viability in the context of quarantining losses.

The object of the non commercial loss provisions is to act as an integrity measure by preventing losses from non-commercial activities that are carried on as businesses by individuals (alone or in partnership) being offset against other assessable income in the income year the loss is incurred. These provisions operate to defer losses from business activities unless they satisfy a test, are eligible for an exception or the Commissioner exercises the relevant discretion<sup>2</sup>.

The relevant discretion is "...intended to cover a business activity that has a lead time between the commencement of the activity and the production of any assessable income. For example, an activity involving the planting of hardwood trees for harvest, where many years would pass before the activity could reasonably be expected to produce income."<sup>3</sup>

It is important to note that the Commissioner's exercise of this discretion for MIS projects is usually based upon evidence from independent sources (such as an industry expert) that indicates a lead time before income production is appropriate for the relevant MIS product being cultivated. This is in line with the words of the legislation.

## Impacts on participants from the failures of MIS managers

We are preparing a draft taxation ruling for public comment to provide guidance to participants about the tax consequences that flow from the recent failures of MIS managers. We expect this draft ruling to issue in the near future and in a timeframe that enables taxpayers to make the relevant claims in their tax returns. The timing of the ruling will depend to some extent on the outcomes of the receivership and voluntary administration processes of the MIS managers. There is likely to be a variety of circumstances that will need to be considered to identify tax consequences for participants.

There appears to be three scenarios that need to be considered where there is a failure of a MIS manager:

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<sup>1</sup> ATO fact sheet <http://www.ato.gov.au/atp/content.asp?doc=/content/00183234.htm&mnu=47548&mfp=001>

<sup>2</sup> Per paragraph 6 of Taxation Ruling 2007/6

<sup>3</sup> Note attached to section 35-55(1), *Income Tax Assessment Act 1997*.

- where the scheme continues to be implemented in accordance with the relevant product ruling – there is no change to the tax outcomes.
- where the scheme continues but is not implemented in accordance with the product ruling (this could be as a result of the failure of the MIS manager or otherwise) – the tax outcomes will depend upon the application of the tax laws to the particular circumstances.
- where the scheme is wound up or otherwise ceases – the tax outcomes will depend upon the application of the tax laws to the particular circumstances.

The collapse of an MIS manager is not in itself reason to disallow deductions previously claimed by participants in affected MIS arrangements. Any business may fail and legitimate tax deductions are not disallowed in the event that they do fail. It also needs to be appreciated that the participants are running separate businesses to that of the MIS manager, although the contractual arrangements may mean that the failure of the manager may result in the winding up of the participant's business.

If a scheme is wound up as a result of the failure of the MIS manager, the relevant product ruling will no longer apply (and will be withdrawn). It does not generally follow that the law applies in a way that then claws back the deductions previously allowed. However, this will depend on the application of the tax laws to the circumstances of the case.

We are liaising with administrators and receivers of the failed MIS managers to identify potential tax issues as they arise and to facilitate effective communication with participants. We have published information for participants on our website and ATO client contact staff are available to provide general advice on tax related matters to participants who contact us.

#### 4. Reconsideration and testing of ATO view

Some recent media coverage has pointed to the ATO's MIS test case process as being a significant factor in the recent failures of MIS managers.

We do not support this position.

When the two largest MIS managers entered voluntary administration, no mention was made in public statements by the entities or their administrators about the MIS test case.

The Timbercorp administrator, KordaMentha, stated on 23 April 2009 that, "*...the company had been hurt by the combined impact of declining global asset values, tightening credit, the economic downturn and drought<sup>4</sup>.*"

Great Southern's Chief Executive Officer, Cameron Rhodes, stated on 17 May 2009 that it appointed voluntary administrators "*...after the group's club banks declined to continue to support the company's restructuring program<sup>5</sup>.*"

The ATO has always applied the tax laws to MIS arrangements as they have been interpreted by the courts.

By 2006, developments in corporations and tax case law prompted the ATO to reconsider its view on the deductibility of investments in registered agribusiness MIS.

In May 2006 the former Government announced arrangements for the taxation of plantation forestry to remove the uncertainty surrounding whether MIS investments were deductible under tax law.

As the ATO's reconsidered view (that the investments were capital and therefore not deductible) was not free from doubt, we sought to minimise impacts on the agribusiness MIS industry while seeking to test the matter through the courts.

<sup>4</sup> KordaMentha media release 23 April 2009 at

<http://www.timbercorp.com.au/userdocs/1/corporate%20shareholders/documents/KordaMentha%20announcement.pdf>

<sup>5</sup> Great Southern media release 17 May 2009 at <http://www.great-southern.com.au/>

The Commissioner announced in March 2007<sup>6</sup> a transition period of nearly 16 months with the reconsidered ATO view to apply from 1 July 2008. It was intended to allow sufficient time for the matter to be tested in the courts, while recognising that it was up to the industry to bring forward a suitable case to dispute.

Because of the protection provided by previous Product Rulings, no investors in agricultural MIS covered by a product ruling and implemented in accordance with that ruling were affected by the reconsidered ATO view or the test case.

The ATO sought the assistance of the industry in March 2007 to identify a suitable case to test in the courts. Despite several communications with industry representatives, a final private ruling request to form the basis of the test case was not received until 16 November 2007 additional information needed to be sought after this date<sup>7</sup>.

Importantly, the previously announced new taxation arrangements for plantation forestry came into effect on 1 July 2007 providing upfront deductions to investors for qualifying forestry expenditure. Accordingly, the ATO continued to issue product rulings for qualifying forestry MIS arrangements during the test case period.

When the details of the private ruling to be tested were finalised and a reviewable dispute came into existence, industry agreed with us to jointly request an early hearing of the matter and for the test case funded by the ATO to be heard by the Full Federal Court in the first instance. The Federal Court agreed to the request.

The Federal Court handed down its decision (*Hance & Hannebery v FC of T*) on 19 December 2008, accepting the industry argument that investment in the MIS arrangement was deductible.

On the same day the Commissioner publicly accepted<sup>8</sup> the Court's decision and we moved to quickly finalise product ruling applications for the 2009 income year. Only five applications for product rulings had been received under arrangements that had been offered to stockpile product ruling applications after 1 July 2008. All five product ruling applications were subsequently revised by the MIS managers and have since been finalised by the ATO.

The Commissioner appreciated the assistance of industry representatives on the test case, as well as the Federal Court for agreeing to hold a Full Court hearing in the first instance and in dealing with the matter in a timely fashion.

The test case demonstrates that important tax disputes can be progressed through the courts relatively quickly with industry cooperation and the support of the judiciary.

## 5. Compliance issues in the MIS industry

Since the inception of the product ruling system, we have had a program of undertaking site visits on a sample basis to check the implementation of schemes following the issue of product rulings.

To date, these site visits have only found minor issues of difference which we ensured were rectified through liaison with the relevant responsible entities and did not require the withdrawal of product rulings or any other action affecting the tax consequences for participating taxpayers.

In addition to the site visit program, we follow up on specific intelligence received from the community about concerns about the implementation of a scheme.

We currently have under investigation for potential contraventions of the promoter penalty laws a small number of cases relating to MIS arrangements. These cases include some smaller scale MIS arrangements and financing arrangements involving on-sellers of some larger MIS arrangements.

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<sup>6</sup> ATO media release - <http://www.ato.gov.au/corporate/content.asp?doc=/content/00095911.htm>

<sup>7</sup> Chronology of test case process in National Tax Liaison Group minutes 26 March 2008 -

[http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00145020.htm&page=16#P556\\_72999](http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00145020.htm&page=16#P556_72999)

<sup>8</sup> ATO media release - <http://www.ato.gov.au/corporate/content.asp?doc=/content/00175824.htm>

Where we find evidence of potential criminal activity, we are able to refer matters to the appropriate law enforcement agency or agencies.

We seek to work with regulatory agencies, such as the Australian Consumer and Competition Commission and Australian Securities and Investments Commission, in relation to a range of MIS related matters. However, disclosure of taxpayer information to other agencies in respect of civil contraventions (i.e. matters that are not serious criminal offences) is limited by secrecy provisions in the tax laws.

## Examples of advice provided by MIS managers on product rulings

Great Southern, in its 2009 Future Forestry Fund Product Disclosure Statement, published the following:

*It should be noted that in the Product Rulings the Commissioner of Taxation rules only on the availability of claimed tax benefits but gives no guarantee of any sort as to the commercial viability of the Tree Projects, or that any fees charged are reasonable, commercial, or are in line with industry norms. The issue of a Product Ruling is not an endorsement by the Commissioner of Taxation that the Projects are a sound financial investment. Growers should be aware that full benefits to be derived from their participation in the relevant Project will in part depend on their ability to utilise the taxation benefits detailed in the Product Ruling and accordingly they should seek advice from their professional taxation advisers on the taxation ramifications of participation in the Tree Projects<sup>9</sup>.*

Timbercorp's website advises:

*All Timbercorp prospectus offerings have a Product Ruling, which tells investors that they can have confidence in the tax outcome of their investment, provided the arrangement is implemented in the way that it has been explained to the ATO in the Product Ruling<sup>10</sup>.*

Rewards Group carries the following:

*By giving a product ruling, the ATO does not guarantee the investment or its commercial viability. It provides no assurance as to the level of charges, or whether they are reasonable, or the level or reasonableness of any projected returns. Investors must form their own views on these matters<sup>11</sup>.*

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<sup>9</sup> 2009 Future Forestry Fund Product Disclosure Statement

<sup>10</sup> Timbercorp website at <http://www.timbercorp.com.au/default.asp?Initialcontentid=10940>

<sup>11</sup> Rewards Group website at <http://www.rewardsgroup.com.au/cms/rg/pages/InvestinginAgribusiness/ProductRuling.html>