

Non-Forestry Managed Investment Schemes

Issues Paper

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Non-Forestry Managed Investment Schemes — Issues Paper

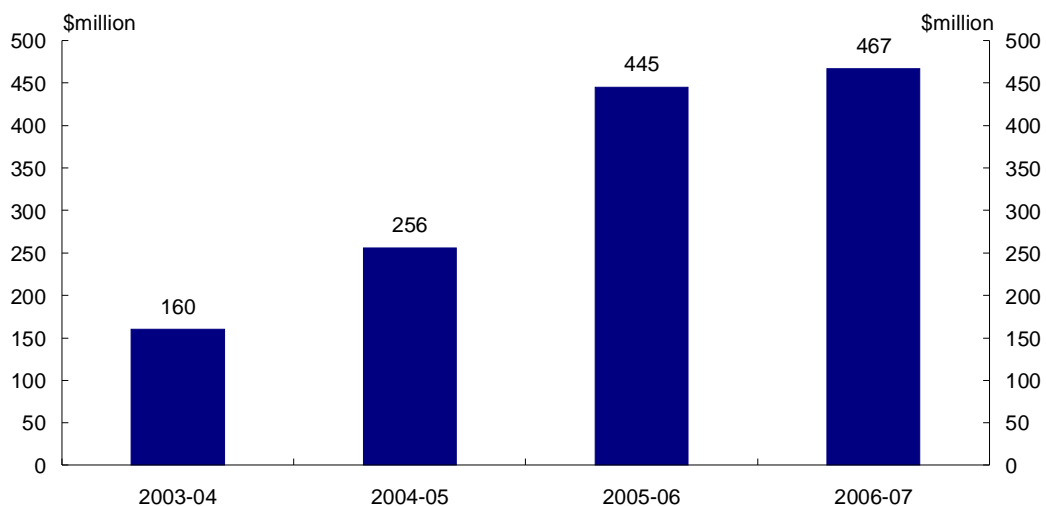
THE REVIEW

1. In Labor's *Plan for Primary Industries*, released on 20 November 2007, the Government undertook to 'consult widely with the investment and rural community to comprehensively review the costs and benefits of managed investment schemes (MIS)'. Given that forestry MIS has been recently reviewed, which resulted in Division 394 of the *Income Tax Assessment Act 1997* being enacted, this review will not include forestry MIS.
2. Investment in non-forestry agricultural MIS (non-forestry MIS) has been an area of recent growth. The Australian Agribusiness Group (AAG) estimates that non-forestry MIS contributions (excluding commitments for future payments) have almost tripled in three years, from \$160 million in 2004 to \$467 million in 2007.
3. Some believe that growth in non-forestry MIS is due to unfair tax advantages. They also believe that the growth in non-forestry MIS increases input costs, diverts resources from more efficient and/or sustainable activities, and could result in over-investment in certain industries which has resulted, or will, result in commodity gluts.
4. In contrast, others believe that due to non-forestry MIS's ability to attract funds they can achieve economies of scale and other efficiencies that generate a lower cost structure than traditional farmers, introduce world best practice, drive research and development, use water more efficiently and open up global supply chains through their marketing efforts. In addition it is believed that lower global commodity prices are encouraging the emergence of large operations in the primary production sector, that have economies of scale.
5. Both groups believe that non-forestry MIS affect rural employment. Some believe MIS operations revitalise agricultural areas by generating employment and contract servicing opportunities for both the immediate business operations and the wider business community. Others believe that MIS are replacing traditional agricultural operations with capital-intensive agriculture that requires less labour, thereby causing depopulation in rural areas.
6. This review will examine the economic, environmental and social impacts of non-forestry MIS. To assist in identifying and quantifying the impact of non-forestry MIS, Treasury invites interested parties to contribute information.
7. This paper outlines the information that Treasury seeks from these contributors and provides guidelines on how to convey opinions to the review team. The issues outlined in this paper are not exclusive. Submissions may raise other issues, relevant to the broad range of the review.

GROWTH OF NON-FORESTRY MIS

8. MIS are collective investments. MIS participants contribute money which is pooled and used in a common enterprise where MIS participants do not have day-to-day control over operations (section 9 *Corporations Act 2001*). A large number of investment options are structured as MIS, for example cash management trusts, property trusts, and equity (share) trusts. Most of these are structured as unit trusts.
9. Non-forestry MIS involve the conduct of some type of agricultural activity, for example the growing of horticultural products for sale or livestock production. They are generally structured differently to other MIS. Rather than being structured as unit trusts, non-forestry MIS are structured in a manner that establishes each MIS participant as carrying on their own business. This is discussed in greater detail below.

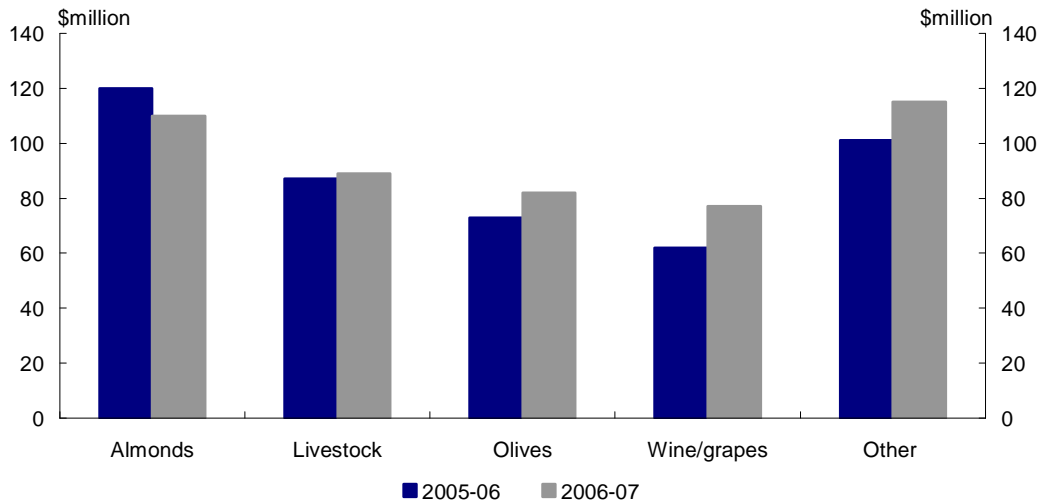
Chart 1: Growth in initial contributions to non-forestry MIS



Source: AAG.

10. Contributions to non-forestry MIS have grown rapidly, except in 2006-07. In 2006, the Australian Taxation Office (ATO) announced that from 1 July 2007 (which was later extended to 1 July 2008) the tax treatment of contributions paid by non-forestry MIS participants would change and that the contributions no longer would be tax deductible. The ATO's change in view is contained in Taxation Ruling TR2007/8. This change in view is being challenged through the court system. A decision on the test case by the Full Federal Court is not expected until late 2008.
11. Non-forestry MIS are involved in the cultivation of abalone, almonds, avocados, berries, cattle, coffee, dried fruit and vegetables, ginseng, grains, macadamias, olives, orchards (apples, apricots, cherries, citrus, mangoes and other tropical fruit), pearls, tea trees, truffles, wine grapes and walnuts. Traditionally, olives and wine grapes have been the preferred crops. Recently, however, almonds and livestock have become popular.

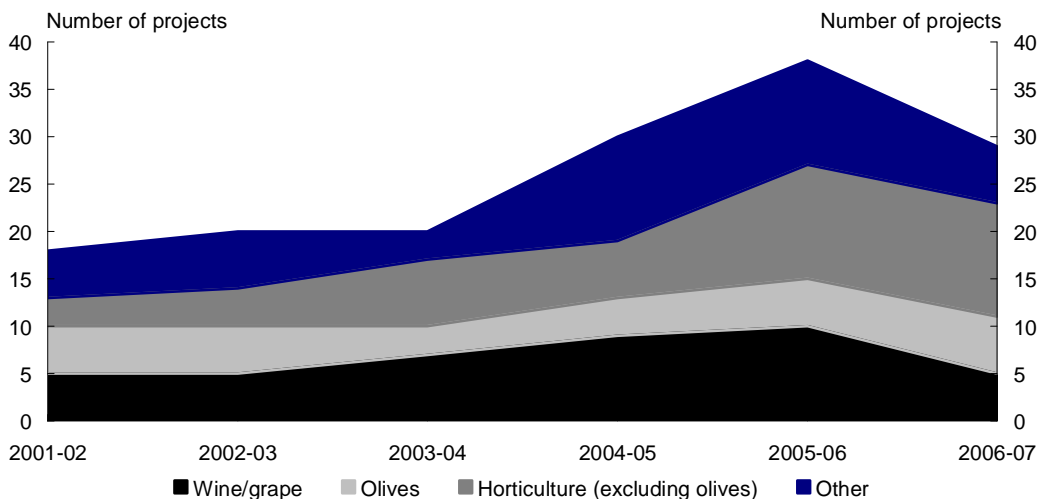
Chart 2: Amounts contributed to non-forestry MIS



Source: AAG

- The number of newly released agricultural projects increased significantly between 2005 and 2006. Non-traditional non-forestry MIS (that is not olives and wine grapes) more than doubled in the 2005-06 year.

Chart 3: Number of new non-forestry MIS projects



Source: AAG

How are non-forestry MIS structured?

- Each non-forestry MIS (hereafter referred to as MIS) is structured differently, although it is possible to generalise for the purpose of providing a high-level picture of how they operate. The agreements in a MIS generally consist of a constitution, a management agreement, a head lease and sublease, and a compliance plan. Other agreements such as subcontracting agreements, sale contracts and financing agreements are often present.
- The MIS operator leases land and water rights from land owners which are often associated with the MIS operator. The land owner usually funds all land preparation and infrastructure necessary for the project and acquires all necessary

water licences. Most MIS projects are either fully or partially developed by the landowning entity at the time MIS participants are accepted into the project.¹

15. After leasing the land and water rights, the MIS operator then divides these into allotments or plots, which are then subleased to individual MIS participants to conduct agribusinesses. Allotment sizes are generally small, for example 0.02 to 0.25 hectares (200 to 2,500 square metres).
16. The MIS operator then enters into a management agreement to operate and manage the agribusinesses of MIS participants. The management agreement will be the same for all the MIS participants — often there are not individual management agreements, rather there is a master agreement to which a list of MIS participants is attached.
17. MIS participants have no bargaining rights in relation to how services are to be conducted or the price of those services. Some management agreements contain clauses giving a MIS participant a right to be consulted or to make suggestions about the activities to be carried out, however this usually involves accompanying procedures and additional costs, which make it practically difficult.
18. MIS participants pay the MIS operator an up-front fee as well as annual rent and management fees in return for managing the MIS project. Some of these fees are calculated as a percentage of harvest proceeds.
19. MIS participants can finance their contributions through their own means or borrow from a finance company that the MIS operator suggests. This finance company is sometimes associated with the MIS operator. MIS participants' contributions are then pooled and used by the MIS operator to run the business.
20. The MIS operator enters into an operations agreement with another entity, the MIS manager, who is usually also associated with the MIS operator. The MIS manager manages day-to-day operations, from preparing land to harvesting. The MIS manager usually conducts these activities through contracting third parties to undertake the work. Generally the contractor makes the major decisions on how the farming activities are conducted with the MIS manager overseeing.
21. Once the crop is harvested, the MIS operator contracts one or more companies to pack, store, transport and market the product. The companies may be related to the MIS operator, but often are independent companies.
22. The MIS operator receives the proceeds from the sale of the harvested product and once received, holds them on trust for the MIS participants. The MIS operator keeps a proportion as a harvesting/marketing fee and distributes the remainder to MIS participants in proportion to the funds contributed and number of interests held. All produce grown on the project is pooled and the amount that a MIS participant receives takes no account of the price received for the variety grown on their individual allotment or of the yield from their allotment.

¹ To ensure a wide range of people can easily understand this document, this paper has used layman's terms rather than legal terms. MIS participant is a reference to the scheme member. MIS operator is a reference to the responsible entity.

KEY ISSUES TO BE CONSIDERED

23. This review will consider the costs and benefits of MIS from an economic, environmental and social perspective. In particular, the review will consider:
- Do MIS have a tax advantage?
 - How well do MIS perform?
 - What is the impact of MIS on inputs, the environment and regional areas?
 - What is the effect of MIS on commodity markets?

SUBMISSIONS

24. The Government seeks the views of interested persons on matters concerning the costs and benefits of MIS. To assist those wishing to make a submission, questions are at the end of each chapter. However, please feel free to address any issue raised in this paper, and do not feel obliged to address every question.
25. Submissions provided on this paper are intended to be made publicly available via the Treasury web site. If you would like your submission, or any part of it, to be treated as 'confidential' please indicate this clearly on the submission. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.
26. The closing date for submissions is 12 September 2008.
27. Submissions can be made via post or email.
28. Post submissions to:
- Review of Non-Forestry Managed Investment Schemes
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
29. Email submissions to misreview@treasury.gov.au

TOPIC 1: IS THERE A TAX ADVANTAGE?

30. Some believe MIS participants have a tax advantage that traditional farmers do not have. Promotional literature produced by MIS operators, financial advisers and rating agencies highlights the tax deductibility of contributions made to a MIS, as a benefit associated with a MIS.
31. It is considered that this advantage provides MIS operators with cheaper finance which allows them to pay higher prices for factors of production such as land and water and allows MIS operators to invest in sub-optimal farming activities. Further, it is believed that the tax advantage obtained by MIS participants 'blinds' them to the fundamentals underlying the MIS operations.
32. Others consider that the tax law applies in the same way to traditional farmers as it does to MIS participants and that critics fail to properly understand the structure of MIS. Further, a project must still offer a rate of return which exceeds that available for alternative investments.
33. Below is an outline of the opinions on whether, from a legal or economic perspective, a MIS has unique tax benefits which allow MIS operators to receive cheaper finance.

LEGAL PERSPECTIVE

34. People acquiring a business can choose between several business structures. They can buy shares in a company, purchase units in a unit trust, become a partner in a partnership, conduct business as a sole trader, or participate in a MIS.
35. People buying fully paid up shares in a company risk the amount paid for the shares. If the company encounters financial difficulties, the shareholder is protected from contributing further financial assistance to the company. From a tax perspective, provided the person is not a share trader, the amount paid for the shares will be treated as a capital amount and is not deductible in the year paid, nor assessable to the company that receives it.
36. People purchasing units in a unit trust are usually in a similar position. Due to terms in the constitution of the unit trust, the unit holder is generally protected from contributing further financial assistance to the unit trust. The amount paid for the unit will normally be treated as a capital amount and it is not assessable to the unit trust that receives it.
37. A person could become a limited liability partner in a limited partnership. Limited liability partners are similar to shareholders in a company: they do not take part in the management of the business and their liability is limited to their investment in the partnership. From a tax perspective the limited partnership is treated as a company and the limited liability partner is treated as a shareholder. As a consequence, the amount paid by the limited liability partner is treated as a capital amount that is not deductible in the year paid, and it is not assessable to the limited partnership that receives it.
38. From a risk perspective, becoming a partner in a general partnership is significantly different. If the general partnership encounters financial difficulty, the

partner (whether silent or not) must provide financial assistance. When a person becomes a partner in a general partnership, the old partnership is dissolved and a new partnership is formed. The amount paid by the partner to enter the partnership is a payment for the underlying assets of the partnership. As such, the payment will most likely be treated as being for a combination of trading stock (or work in progress), depreciable assets and capital assets. A significant proportion of the partnership contribution would not be deductible in the year the initial payment is made when calculating the net income of the partnership.

39. A sole trader is similar to a partner. A sole trader takes on unlimited risks. From a tax perspective, the initial outlay by a sole trader is treated as trading stock (or work in progress), depreciable assets or capital assets. A significant proportion of the initial payment would not be deductible when it is made.
40. Becoming a MIS participant requires a financial contribution to the MIS operator. Due to the way fees are structured as a predetermined amount under the agreements, the MIS participant is generally only ever liable for the amounts specified in the agreement.
41. MIS agreements establish that the MIS participants are, from a legal perspective, carrying on their own separate business. Accordingly, the amount paid as a MIS contribution has had the same tax treatment as the initial outlays made by sole trader — a mixture of capital and tax deductible amounts.
42. The structure of non-forestry MIS has evolved. In the 1990s, initial contributions by MIS participants covered a mixture of capital and tax deductible items. Most non-forestry MIS required participants to pay for infrastructure on their allotments and pay a management fee and a lease or licence fee. If the participant contributed to a viticulture project, fees would include the costs of the trellising, irrigation, grapevines, land care, and other infrastructure. Such fees are allowable under capital allowances provisions and, therefore, are not wholly deductible when paid.
43. Since 2000, the way MIS are structured has changed and initial contributions by MIS participants have become almost exclusively tax deductible. Now under most MIS, the land and infrastructure is acquired by the MIS operator or third party and MIS participants only pay management fees and lease or licence fees. There are no or few fees for capital expenditure; rather, in most cases project infrastructure is leased or licensed. The ATO is challenging the tax deductibility of participant contributions before the courts.

Table 1: Comparison of business structure

Type of structure	Amount at risk	Tax treatment
Shares, units and limited partnership interests	Limited to share/unit cost	Capital
General partnership interests and sole traders	Unlimited	Mixture of deductible and capital amounts
MIS participants pre 2000	Limited due to contracts	Mixture of deductible and capital amounts
MIS participants post 2000	Limited due to contracts	Deductible

44. Some people see deductions being given for something that they perceive to be capital expenditure. This perception is reinforced by the fees charged for the initial period in an MIS project generally being disproportionately higher than the fees charged in following years, and an impression that the initial fees are used to fund what are regarded as non-deductible capital items. In addition, the marketing of many MIS indicates that a benefit of such structures is the tax break provided, due to the immediate claiming of deductions, when income produced on the sale of the produce will not arise until later years.
45. Others perceive MIS as merely a way of conducting business which is no different to other business decisions that people make, for example whether they want to own or lease their business premises or whether they undertake the work or sub-contract to others. MIS participants pay for the rental of fully developed land and professional managers. In contrast, most traditional farmers own their land, work it themselves and pay for seedlings.
46. Some alternative ways that farmers could conduct their business include:
 - contract farming
 - These farmers contract to sell some or all of their output to a specific customer before the output is grown. The risk of a failed crop is shared with the customer, because the farmer will be paid regardless of whether the crop is successful. The flip side to this is that the farmer will not be able to take full advantage of increases in market price. Contract farmers often own the land and infrastructure which are used to grow the crop.
 - share farming
 - Share farming is where two parties jointly farm the same land. Typically, a share farming arrangement involves the owner or tenant of farm land (the land owner) who enters into a contract with a working farmer (the share farmer). The landowner provides the farm land and buildings, fixed equipment and machinery, major maintenance of the buildings and his expertise. The share farmer provides labour, field and mobile machinery and his expertise. Other costs such as seed, fertilisers and feed are shared, and produce of the farm is shared between the parties.
47. Furthermore, it is argued that this method of raising finance is open to everyone. A small number of primary producers have used MIS when they are starting or about to significantly expand operations, so that they can obtain funds in the cash flow sensitive stages.
48. To use a MIS structure, farmers would need to form a public company that has an Australian financial services licence authorising the company to operate a MIS. Among other things they would need to prepare a product disclosure statement, constitution and compliance plan; establish a compliance committee meet a number of reporting requirements and establish financial adviser distribution networks. The costs of undertaking this would be substantial.

ECONOMIC PERSPECTIVE

49. If MIS participants assume limited risk and are not actively involved in managing the MIS, then, from an economic perspective, it may be appropriate for non-forestry MIS participants to be regarded in a similar way to share and unit holders rather than sole traders and partners.
50. Most MIS participants only sign the application form in the product disclosure statement. This gives the MIS operator an irrevocable power of attorney to do practically everything during the term of the project and make all decisions. This indicates that MIS participants are not actively involved in the management of the MIS.
51. Analysis of MIS documentation indicates that the risk assumed by MIS participants is mitigated. For example, the scheme constitution usually limits the liability of each grower and indemnifies them against debts and liabilities. It is also common for insurance to be held on behalf of the grower for 'public liability and occupier's liability'.
52. In addition, risk is also mitigated by the business structure whereby the MIS participant does not take part in the operations, does not employ anyone, rarely owns any assets, and contracts everything to the MIS operator, which in turn usually subcontracts to third parties which would be responsible for their own actions.
53. The size of the MIS participant's business does not support the view that a real business is being carried on. For example, the allotment size of vineyards is commonly 0.05 hectares (500 square metres), but can be as small as 0.025 (250 square metres) or 0.02 hectares (200 square metres). When this contribution is spread across a number of geographical areas, the allotment size is even smaller. For example, one project's allotment of 0.5 hectares is split over several properties in two different States: the split is 0.0141 (141 square metres), 0.0074 (74 square metres), 0.0112 (112 square metres), 0.0074 (74 square metres) and 0.0098 hectares (98 square metres). Allotments of these sizes would not generally be a viable size for an independent farm operation.

COST OF CAPITAL

54. Table 2 demonstrates how the timing of tax affects the rate of return generated by each business structure for an individual on the top marginal tax rate (45 per cent excluding the Medicare levy). The example assumes that \$100 is paid to obtain the business structure at the start of the income year and the business structure is sold for \$150 in 10 years at the end of the income year. It also assumes a 10 per cent discount rate, and that partnership and sole trader transactions involve 50 per cent tax deductible items and 50 per cent capital items which are not subject to capital allowances but use the 50 per cent capital gains tax discount.

Table 2: Comparing the rate of return for the different business structures

	Company/unit trust/limited partnership	General partnership/sole trader/MIS pre 2000	MIS post 2000
Year one			
Cash out	-100.00	-100.00	-100.00
Tax	0.00	22.50	45.00
Net cash flow	-100.00	-77.50	-55.00
Year ten			
Cash in	150.00	150.00	150.00
Tax	-11.25	-39.37	-67.50
Net cash flow	138.75	110.63	82.50
Rate of return (per cent)	3.33	3.62	4.14

55. Table 2 shows that the post-2000 MIS structure yields the investor an after-tax rate of return that is greater than other types of investment. Given that investor decisions are based on the return that they actually receive (the after-tax return), it follows that a MIS can actually produce an internal rate of return that is lower than other investments, whilst the after-tax return to the investor is equal to that of the other investments.
56. The difference between the rate of return for shares/units compared to general partnerships/sole traders and MIS pre 2000 can be attributed to the business structure that is adopted. The difference between the rate of return of general partnerships/sole traders and MIS post 2000 could be attributed to a different way of conducting a business.

ATO POSITION

57. The ATO has changed its position regarding the tax deductibility of MIS contributions. In TR2007/8, the ATO expressed the view that MIS participants are not carrying on a separate business, rather they are akin to passive investors. Although the ATO's changed position is currently subject to a challenge in the Federal Court, TR 2007/8 indicates that the ATO has reached this view on a number of bases that include the following:
- Rarely, if ever, does it make commercial or agricultural sense to operate a large number of separately managed smaller businesses, as distinct from one large enterprise.
 - MIS participants do not have day-to-day control over the running of the project, and often are actively encouraged not to interfere in this respect.
 - The MIS regulations are premised on MIS participants being passive investors.
 - MIS participant returns are calculated with regard to the operation of the project as a whole, rather than being confined to the operations of an individual business.

SUBMISSIONS

58. Submissions are invited to:

- **provide further information, both quantitative and qualitative, regarding MIS growth;**
 - **by geographical area;**
 - **by commodity;**
 - **in aggregate; and**
 - **in contrast to other areas of the economy;**
- **detail how MIS are structured. In particular, submissions are invited to comment on:**
 - **risks assumed by MIS participants in contrast to risks assumed by participants in other business structures;**
 - **level of involvement of MIS participants in the business compared to participants in other business structures; and**
 - **the structure of MIS business operations, compared to traditional agricultural business operations;**
- **analyse the appropriateness of using MIS as part of an investment portfolio;**
- **quantify and comment on the tax benefit, if any, associated with MIS structures;**
- **comment on costs of compliance with tax obligations (including GST and WET);**
- **describe the advantages and disadvantages of using MIS as a means to finance, including:**
 - **the extent that traditional businesses use MIS to finance their operations;**
 - **the availability of alternative financing mechanisms.**
- **comment on the fee structure of MIS, including the disparity between initial and ongoing fees.**

TOPIC 2: HOW WELL DO NON-FORESTRY MIS PERFORM?

59. MIS operators consider that their operations are highly efficient, a requirement for competing in global agricultural markets. These efficiency advantages are based on the ability of the MIS to raise finance. Firstly, the finance available to MIS operators allows them to run larger operations than traditional farmers relying on traditional financing methods. The MIS operators believe that larger agricultural operations achieve lower unit costs or efficiencies of scale. Secondly, the finance available to MIS operators means that they can afford the most efficient, modern technology and that they invest more in research and development which will benefit primary production in general not just MIS.
60. Some MIS operators also consider that they mitigate uninsurable risks for traditional farmers by:
 - not requiring farmers to take out loans to finance their operations (MIS participants provide the funds); and
 - pooling produce between a number of locations and production zones. Pooling produce is a particular bonus as farmers can insure against fire and hail, but they may have difficulty in insuring against drought, frost or flood. Pooling produce from various regional areas diminishes the risk of a crop being affected by drought, frost or flood.
61. Others believe that funds given to MIS are partly used to pay high commissions to financial advisers and they also generate supernormal profits for MIS companies. There has also been debate about the adequacy of financial information concerning MIS.
62. The review intends to analyse the performance of MIS from both a financial and production perspective. This will involve analysing the return on investment to the MIS participant and MIS operator, and both the quality and quantity of the agricultural yield obtained by the MIS.
63. In analysing the return on investment, the review will analyse how risk is shared between MIS participants, MIS operators and third parties, and whether that is appropriate for the level of return.
64. The structures that are used for operating non-forestry MIS may also raise investor protection issues. In particular, models that involve the MIS being structured as individual business activities of the investors might affect the quality of financial information provided to investors in the MIS's financial statements. Some non-forestry MIS balance sheets might not show regularly updated valuations for the growing assets. In addition, the holding of the interest (in the land on which the primary production may occur) by the MIS operator beneficially, rather as trustee for the investors, may expose investors to additional risks, for example if the MIS operator mortgages the interest in land.
65. Under the *Corporations Act 2001*, a person making financial predictions about a financial product to investors must have reasonable grounds to make it. In light of the risk of predictions misleading retail clients, ASIC has issued Regulator Guide 170 *Prospective financial information*. In practice Product Disclosure Statements for non-forestry MIS rarely include forecasts, at least beyond a short term. Instead

there are a number of research houses that evaluate MIS offerings and provide information to potential investors.

66. On 22 May 2008, the Minister for Superannuation and Corporate Law announced that Treasury, working closely with ASIC, would undertake the Australian Review of Credit Rating Agencies and Research Houses. This review will examine the regulation of credit rating agencies and research houses in Australia, with a view to ensuring that the system is appropriate and up to date. The review will also look at how ratings advice is used by retail and wholesale investors. Input will be sought from the Australian Prudential Regulation Authority (APRA) and other relevant agencies, as well as stakeholders from the investor, financial planning, shareholder and superannuation communities. It is anticipated that the review will report in November 2008, with relevant findings feeding into the review of non-forestry MIS.
67. Accordingly this review will not seek submissions on the independence of research houses and the quality of information they provide. If you wish to make a submission regarding research houses please direct your comments to the Australian Review of Credit Rating Agencies and Research Houses.²

SUBMISSIONS

68. Submissions are invited to:
- describe the risks that are assumed by entities involved in MIS operations;
 - detail the returns that MIS operations have generated and how those returns have been allocated between entities involved in the MIS operations;
 - compare the before-tax returns generated by MIS operations to:
 - industry averages;
 - forecasts in the product disclosure statement;
 - forecasts made by research houses;
 - other business models;
 - provide production performance (both quality and quantity) criteria of MIS operations and industry standards, such as:
 - production per hectare;
 - production per employee;
 - water usage (megalitres/hectare);
 - water usage (megalitres/tonne);

² Further details of the Australian Review of Credit Rating Agencies and Research Houses will be made available at the Treasury website (www.treasury.gov.au).

- **production cost per hectare***;
- **production cost per tonne***;

*Production costs should include all costs faced by operators (not investors), including capital costs.

- **document the type and level of research and development MIS operators undertake and compare that to industry norms;**
- **document the commissions paid by MIS and the profits generated by MIS operators, including:**
 - **the proportion of MIS participant funds used in the agricultural operations as opposed to being paid as commissions to financial intermediaries or profit to the MIS operators and associated entities;**
 - **comparing the commissions and profits associated with MIS entities to industry standards and other business models;**
- **describe the advantages and disadvantages of using MIS as a means to manage risk, including:**
 - **the extent that traditional businesses use MIS to manage risk in their operations;**
 - **the availability of alternative risk management mechanisms, such as hedging;**
- **comment on the adequacy of financial information concerning MIS. In particular:**
 - **the disclosure of financial information in product disclosure statements;**
 - **the ease of determining fees and commissions payable in relation to MIS;**
- **describe any particular risks to investors that arise because of the way in which non-forestry MIS are structured as business enterprises of individual investors rather than a trust held for the investors in a scheme.**

TOPIC 3: INPUTS, THE ENVIRONMENT AND REGIONAL IMPACTS

69. MIS operations are in all States and the Northern Territory. An analysis of MIS product offerings and MIS product rulings indicates that the following regions have had an influx of funds by MIS:
- Albany/Busselton
 - Mareeba
 - the Grampians area of Victoria
 - Mildura, Swan Hill, Robinvale, Boundary Bend, Euston and Boort
 - the Riverland — Renmark
 - SA wine regions including Langhorne Creek, the Limestone Coast, the Barossa Valley, Padthaway and Coonwarra
 - WA wine regions including Margaret River and Mount Barker.
70. The review will be taking a particular interest in these areas when it is addressing the issues raised in this part of the review.

INPUTS

71. Some consider that, due to their access to financial resources, MIS operators are able to acquire large tracts of land and water resources at prices in excess of those that a traditional farmer would pay. Consequently, they believe that resources are misallocated from efficient agricultural operators to MIS operators.
72. Others consider that MIS operations are more efficient due to economies of scale. Accordingly, MIS can generate a greater profit which they can use to purchase inputs from less efficient farmers.
73. An increase in the price of inputs (even if caused by MIS) by itself does not indicate MIS are positively or negatively affecting the economy. Other considerations, such as the overall rate of return before tax on MIS projects compared to traditional agriculture, need to be taken into account.
74. Due to the sensitivity of this issue, the review will examine how, if at all, MIS have affected land and water prices.

ENVIRONMENT

75. Some believe that some MIS operate in an environmentally unsustainable manner. A few MIS have been criticised for irrigating properties that traditionally were dryland properties that may not otherwise be suitable for irrigated development. It has also been argued that non-forestry MIS use large amounts of water which has a negative effect on river systems.

76. In contrast, MIS operators emphasise the environmental sustainability of their operations and their management structures that ensure adherence to environmental laws, regulations, and codes of practice.
77. The review will also examine the environmental impact, if any, of MIS operations.

REGIONAL IMPACT

78. Land acquired by MIS could be used to continue the existing agricultural pursuits or undertake different agricultural pursuits.
79. If land acquired by a MIS is used to continue existing agricultural pursuits, people in the area are unlikely to be displaced unless the MIS operator employs less labour-intensive agricultural practices, uses non-local labour or uses larger supplier organisations which are located outside the relevant geographical area.
80. If land acquired by a MIS is used for different agriculture pursuits, then those alternative agricultural pursuits may be more or less labour-intensive than the traditional activities. The alternative use may also require different facilities.
81. MIS-induced land use changes may also affect farm-dependent businesses by changing the demand for agricultural inputs (such as tractors and fertiliser) as well as for the handling of outputs (such as fruit packing sheds).

SUBMISSIONS

82. Submissions are invited to:
 - provide evidence of changes to input prices;
 - explain why input prices have changed, for example urban expansion;
 - indicate whether MIS operations have changed land use;
 - identify and explain whether MIS have resulted in land use changes that have increased environmental degradation;
 - discuss whether the change of land use has required investment in infrastructure (for example roads and ports) and what degree of public funding has been required;
 - explain the impact of non-forestry MIS on resource allocation.
 - discuss whether MIS operations have increased or reduced the demand for labour in the region, on-farm and off-farm services, upstream transport and processing facilities.
 - If the requirement for labour has increased, can that requirement be met from the local area?
 - If the requirement for labour has decreased, what jobs are being lost and what jobs are being created? Consider whether the jobs are full time or part time, long term or short term, skilled or unskilled.

TOPIC 4: NON-FORESTRY MIS AND COMMODITY MARKETS

83. Some consider that the change in land use by some MIS is resulting, or will result, in over-production of specific commodities, causing gluts and generally leading to lower commodity prices. Others believe that most commodities operate in global markets and that the change in land use will generate valuable exports for Australia.
84. The review will analyse, to the extent possible, these issues by examining the effect of increased production through MIS on domestic and international markets of the following commodities:
- Almonds
 - Olives
 - Wine grapes
 - Cattle
 - Berries
 - Tea tree oil.
85. Almonds, olives, grapes and cattle represent a significant proportion of non-forestry MIS but may not necessarily comprise a large proportion of total production of green commodity. All of these commodities have been produced by MIS.
86. MIS participation in a number of commodity markets has been relatively recent. Given the length of the lead time to production, and absence of a forward contracts market, the following commodities will not be analysed:

<i>Commodity</i>	<i>Years to harvest</i>	<i>First year of MIS involvement</i>
Abalone	2.5-4.5	2005
Ginseng	4-8	1999
Pearling	4	2005
Walnuts	8	2006

87. Economic theory proposes that, all things being equal, an increase in supply lowers the price of the commodity. Whether this price reduction is sustainable depends upon whether the cost structure allows the producer a reasonable rate of return.
88. In reality, all things are not equal. The global demand for food could increase and place upward pressure on the price of commodities, or MIS operators could launch significant marketing campaigns to increase demand. Alternatively, the cost structures of global competitors could facilitate consolidation within the Australian primary production sector to achieve economies of scale.
89. However, for some commodities, Australia is a price taker not a price setter, with prices set by global commodity market.

SUBMISSIONS

90. Submissions are invited to:

- analyse a selected (or recommended) market;
 - What is the level of domestic production of the commodity?
 - What is the level of domestic consumption of the commodity?
 - What are the preferences of domestic consumers for the commodity? What factors are important to consumers when purchasing this product (for example price or quality factors)?
 - What effect has the entry of MIS had on the market? Do these effects occur on the supply or demand side of the market? What has been the effect on prices and quantities of the commodity? Have prices fallen due to oversupply?
 - What other factors, if any, are affecting the market price?
 - How are non-MIS producers affected by the entry of MIS into the market?
 - Are there any other factors affecting the market? How are these factors affecting the market?
- comment on the international market for the selected commodity(s);
 - What is world production of the commodity? In which countries is the commodity produced? What share of world production is produced in Australia?
 - Compare and contrast the production techniques used in Australia with those of other commodity producing countries.
 - What is the size of world trade in the commodity? To what extent does Australia trade in the selected commodity — how much is exported and imported?
 - What are the trends in the international market? Comment on issues such as changes to cost structures, production techniques, consumer preferences and consumer demand.
 - Are there any barriers to trade that prevent Australian producers from participating in international markets? These can be barriers put in place by governments, such as protectionist policies or quarantine regulations, or non-government barriers such as transport and storage costs or fragility of the commodity.
 - If there are barriers to trade how have Australian producers responded to these barriers? What solutions, if any, do producers advocate?

- To what extent do MIS participate in international markets? Contrast the ability of MIS to participate in international markets with the ability of traditional growers.
- Have the commodities produced by MIS been exported? How much has been exported and to where?
- comment on the sustainability of the present market situation.
 - If the present situation is not sustainable, what changes do you predict will occur in the future, if the current policy settings remain?