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Review of Non-Forestry Managed Investment Schemes
Business Tax Division
The Treasury

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REVIEW OF NON-FORESTRY MANAGED INVESTMENT SCHEMES

We refer to the government's issues paper *Non-Forestry Managed Investment Schemes* issued in August 2008. We are pleased to provide this submission to the review. We appreciate it is being lodged after the closing date, but trust it will still be considered.

Background about McMahon Clarke Legal

We are a specialist commercial law firm which practices in areas of the law dealing with wealth management and wealth preservation. In particular, we have specific expertise in agribusiness schemes having practised in that sector for over 12 years. The firm has published a book *Everything you need to know about Agricultural and Investment Prospectuses*. We act for or correspond with the majority of promoters in the agribusiness scheme industry.

Submission

We have not addressed each of the areas raised in the review, particularly as some of them are better dealt with by promoters and operators within the sector who have relevant data on matters such as input prices, labour statistics and commodity markets. Accordingly, we have grouped our submission under this one heading and not under specific headings.

1. Agribusiness managed investment schemes are one of the most highly regulated forms of investment product. Schemes, and more importantly their operators, are governed by the *Corporations Act 2001*, the *Australian Securities and Investments Commission Act 2001*, the *Trade Practices Act 1974*, the *Horticultural Code of Conduct 2007* and all other regulatory requirements which traditional farmers must meet.

The government agencies which have regulatory oversight of agribusiness schemes include the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission (ACCC) and the Australian Taxation Office (ATO).

2. The risks assumed by scheme participants are greater than investors who buy shares in a company or units in a unit trust. Shareholders and unit holders have limited liability in that they are protected from contributing further financial assistance to the entity in which they have invested if that entity encounters financial difficulties (unless the shares or units are only partly paid). The issues paper notes that due to the way fees are structured as a predetermined amount under the agreements participants enter, participants are generally only ever liable for the amount specified in the agreement. We make two comments on this:
 - (a) The issues paper seems to be indicating a scheme participant has limited liability similar to a shareholder in a company who is liable only to pay any unpaid calls. This is true to a point, however many schemes are now structured so fees payable by participants include a fixed fee component as well as a variable component, being a proportionate share of farm operating costs.
 - (b) The risk participants bear may be a contractual one only but this risk is very real. We act for many agribusiness promoters who have been forced to take legal action against defaulting investors for failure to pay fees due under the scheme agreements. In addition to initiating court proceedings, some operators have had to take steps of enforcing any security they hold over an investor's assets.
3. The taxation implications of investing in non-forestry agribusiness schemes can often be overstated. Participants wishing to claim deductions for their investment in a scheme must comply with the provisions of the income tax legislation. Specifically, deductions are claimed under either of the limbs set out in section 8-1 of the *Income Tax Assessment Act 1997* which enable deductions for any losses or outgoings to the extent that either they are incurred in gaining or producing assessable income or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

These are the general deduction limbs under the tax law and are no different to what anyone else wishing to claim business based expenses must reply upon and satisfy.
4. The perceived disparity between initial and ongoing fees is no longer as great as it admittedly was, say 10 years ago. The requirements of the ATO in obtaining a product ruling for a scheme have brought an acute focus upon the level of initial fees compared to ongoing fees. Despite that, the reasons for higher initial fees, including more intense management and maintenance during the formative stage of a primary production operation, are still well founded.
5. The issues paper refers to "super normal" profits for managed investment scheme companies. This is unnecessarily emotive and, we would submit, incorrect. Regardless, any profit is fully taxable in the hands of those companies.

6. The issues paper also comments that structures used for operating managed investment schemes may raise investor protection issues. In particular, it refers to operators mortgaging the land used by a scheme. The protection of underlying land in primary production schemes has been at the fore front of both ASIC's and the industry's mind for many years. Prior to the managed investments regime, when schemes were structured using a manager and an independent third party trustee, the project land had to be leased to the trustee in such a way that it could not be adversely affected by any mortgage or subsequent transfer. That requirement has carried across to (and is in fact more prescribed under) the managed investments regime in the form of a condition on a scheme operator's Australian financial services licence (see conditions 44-46 of ASIC pro forma 209).

The potential civil and criminal liability imposed on scheme operators and their directors acts as a more than adequate fetter against adversely affecting scheme land.

We welcome the government's review into non-forestry managed investment schemes and would be happy to elaborate on any aspect of this submission.

Sincerely



Langton Clarke

Partner

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