

MIS test case Q&A

MACQUARIE AGRIBUSINESS



With the Federal Court recently ruling on the test case, uncertainty surrounding the tax treatment of horticultural or non-forestry registered managed investment schemes (MIS) has been resolved. This is a welcome outcome for both the industry and investors alike.

What are registered managed investment schemes (MIS)?

Agribusiness MIS enable a group of investors to invest in particular agricultural projects through a scheme registered with ASIC and operated by a responsible entity. Investors have the opportunity to carry on a business of cultivating and selling an agricultural commodity for commercial gain.

There are two main types of agribusiness MIS in the Australian market:

- Horticultural or non-forestry MIS which include commodities such as almonds, avocados, olives, citrus, mangoes and grapes.
- Forestry MIS which include a broad range of timber.

Why invest in agribusiness MIS?

- **Diversification** - the drivers of agriculture are different to traditional assets such as shares which are driven by financial markets. As a result agriculture has historically exhibited low to negative correlation to these assets classes.
- **Growing demand** - the rising affluence of rapidly urbanising populations has accelerated demand for food and other agricultural commodities particularly in emerging markets such as India and China.
- **A real asset** - investors have the opportunity to carry on a business of cultivating and selling an agricultural commodity for commercial gain.

What is the background to the test case?

- Traditionally investors have been entitled to an upfront tax deduction for their investment in agribusiness MIS. (It is important to note that the tax treatment for investors covered by existing product rulings remains unchanged).
- In early 2007 the Australian Tax Office (ATO) announced that it could no longer issue product rulings for agribusiness MIS. The ATO considered that developments in case law had cast doubt on the deductibility of investments in both forestry and non-forestry schemes.
- In October 2007, the ATO issued a ruling confirming that investments in agribusiness MIS offered after 1 July 2008 are not tax deductible.
- This ruling did not ultimately affect forestry MIS because the Australian Government introduced legislation to specifically deal with this type of agribusiness MIS. Investors in forestry MIS (offered after 1 July 2008) are entitled to an upfront tax deduction for their investment (provided that at least 70 per cent of the MIS expenditure was directly related to developing forestry).

What is the test case?

The industry body Agricultural Investment Managers Australia (AIMA) and the Commissioner of Taxation jointly agreed to hold a test case in order to get certainty around the deductibility of contributions to non-forestry MIS. The test case was funded in part by AIMA and in part by the ATO. Macquarie Agribusiness is a member of AIMA.

The test case was based on two private rulings which related to a proposed almond MIS.



What was the outcome of the case?

On 19 December 2008 the full Federal Court of Australia ruled on the test case. The outcome, following a unanimous decision by the Court, is that contributions to non-forestry MIS can be treated as tax deductible. The ATO has subsequently confirmed this decision stating in a media release that investments in MIS arrangements which are broadly similar to the test case are deductible. The ATO is now working to finalise product rulings for 2009 projects.

What does this decision mean for investors?

The outcome of the test case provides certainty for investors that an investment in agribusiness MIS is tax deductible. The tax office is currently working to finalise product rulings for 2009 projects as soon as possible. It is important to note that the tax treatment for investors covered by existing product rulings remains unchanged.

It should also be noted that the application of taxation laws to each investor depends on their individual circumstances. We recommend investors obtain independent financial, legal and taxation advice before making any investment decision.

What were the key points considered by the Court?

One of the main issues raised in the test case was whether investors in this type of MIS were carrying on a business. Under general principles a taxpayer carrying on a business is entitled to a tax deduction for the operating expenses of the business. If investors are not carrying on a business then the Commissioner classified the money put into agribusiness MIS by investors as a capital expenditure – that is, the cost of acquiring an income producing asset or the cost of acquiring an interest in a scheme - which is not deductible.

In respect of agribusiness MIS, the Court considered that a number of the indicators of carrying on a business were present including; repetition of financial obligations, continuing the operation over an extended period of time and obtaining a return for the product. The Court made the particular point that a person carrying on business may delegate functions to others and that in the factual circumstances of the test case, the investors had obligations in respect of the scheme but that these were delegated to the responsible entity. Accordingly the Federal Court confirmed that “the only answer open is that the relevant outgoings will be incurred as operating expenses in carrying on a business”.

Can the Commissioner appeal the decision?

The Commissioner has a period of 28 days (from 19 December 2008) to proceed any appeal against the decision to the High Court. However the ATO has issued a media release accepting the Federal Court's decision and stating that, “We expect to release a decision impact statement shortly, and we do not expect to lodge a request for special leave to appeal the case.”

How does the decision affect forestry MIS?

As previously mentioned the Australian Government has specifically legislated for the tax treatment of forestry MIS. However the ATO has stated, following the test case decision, that investments in MIS arrangements which are broadly similar to the test case are deductible. This provides the scope for forestry MIS providers to apply for a product ruling under these general principles or under the legislation (which requires that at least 70 per cent of the MIS expenditure is directly related to developing forestry).

Are there any projects I can invest in for 2009?

Macquarie has submitted applications for product rulings for its proposed Macquarie Almond Investment 2009 and proposed Macquarie Forestry Investment 2009. Once product rulings are received Macquarie will progress in opening the projects for investment.

Will I get a tax deduction for my investment in an agribusiness MIS?

Investors in agricultural MIS can receive a tax deduction for their investment (subject to the terms of the applicable product ruling being met). The tax treatment for each project will be confirmed in the applicable product ruling issued by the ATO.

It should be noted that the application of taxation laws to each investor depends on their individual circumstances. We recommend investors obtain independent financial, legal and taxation advice before making any investment decision.

Does the outcome of the test case impact investors in past projects?

No. Investments in agribusiness MIS covered by existing product rulings are not affected.

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