

RESPONSE TO THE REVIEW OF NON-FORESTRY MIS ISSUES PAPER

**HORTICULTURE AUSTRALIA COUNCIL
SEPTEMBER 2008**



INTRODUCTION

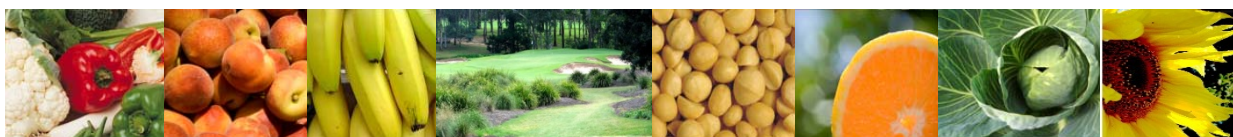
Horticulture Australia Council (HAC) is the peak national industry body representing the Horticultural industries. Members of HAC are the national peak industry bodies (PIBs) for the Horticultural industries, and some State grower organisations. Horticulture Australia Council (HAC) represents over 97% of the Australian horticulture industry, and its Member organisations include:

- Apple & Pear Australia
- Agricultural Investment Managers Australia
- Avocados Australia
- Australian Banana Growers' Council
- Australian Citrus Growers
- Australia Custard Apple Growers
- Australian Dried Fruit Association
- Australian Mushroom Growers Association
- Australian Nut Industry Council
- Ausveg
- Cherry Growers of Australia
- Fruit Growers Victoria
- Growcom
- NSW Farmers' Association
- Northern Territory Horticulture Association
- Nursery and Garden Industry Australia
- Persimmon Industry Association
- Strawberries Australia
- Turf Producers Australia

Horticulture in Australia

Horticulture in Australia is intensive, generally irrigated, agriculture. Horticulture is a diverse industry, spread across the continent in a wide array of climates. Horticulture is the second-largest and fastest growing industry in agriculture; with some 30,000 businesses nationally, and a farm-gate value of \$8 billion.

Total horticultural exports in 2006/07 were \$763 million. As the most labour intensive of all agricultural industries, Horticulture employs one-third of those employed in agriculture. The industry is the principal driver of many local communities and economies in rural and regional Australia.



RESPONSE TO ISSUES PAPER

Investment in horticulture through Managed Investment Schemes (MISs) has grown significantly since 2001. MISs are involved in (at least) the following horticultural industries: almonds, avocados, berries, coffee, dried fruit and vegetables, ginseng, macadamias, garlic, olives, fruit orchards (apples, apricots, cherries, citrus, mangoes and other tropical fruit), tea trees, truffles, wine grapes, table grapes and walnuts.

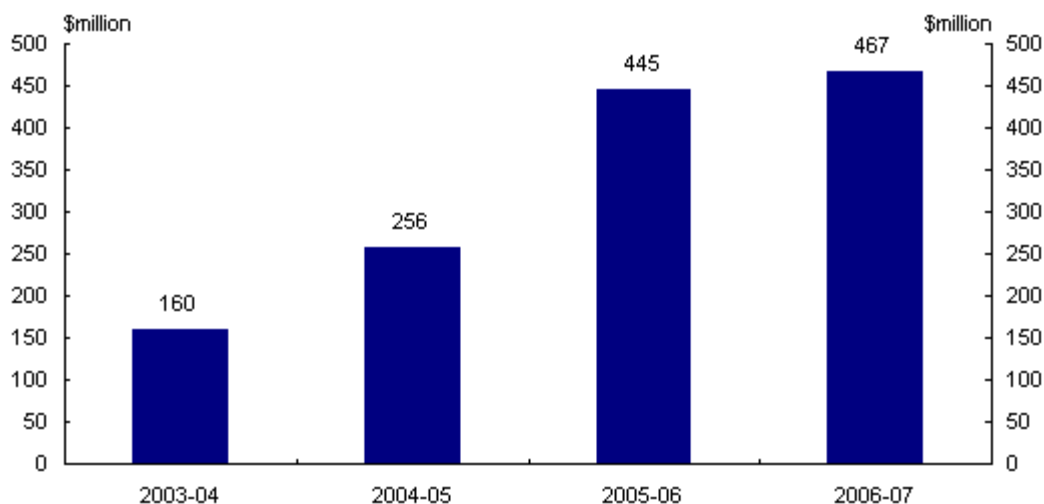
Individual case studies can demonstrate a wide range of impacts of Managed Investment Schemes (MIS), making it difficult to generalise; HAC has therefore taken an overarching view based on policy principles that are relevant to all agricultural MIS.

The Australian Government has identified market failure within some industries (eg forestry, or the arts), and established arrangements to encourage investment (eg through MIS), because there is a reasonable fear that it would not otherwise occur. However, there is no market failure in horticulture - with the exception of the wholesale sector (which the Mandatory Horticulture Code has been introduced to address). Nor is there any necessity to artificially bolster investment in our industries.

Current arrangements for investors in some MISs mean that decisions to invest are largely based on the tax deductibility of the investment (what the ATO refers to as “passive” investment), rather than long-term commercial viability or profitability - i.e. the focus is on input costs, not outputs and real profits.

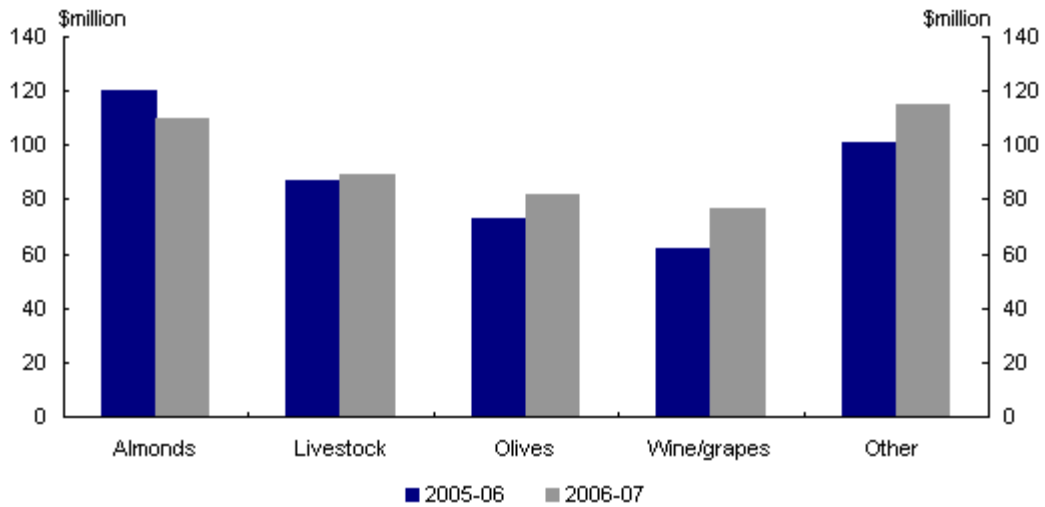
As the Issues Paper has identified, this has led to an enormous growth in such schemes since 2000:

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



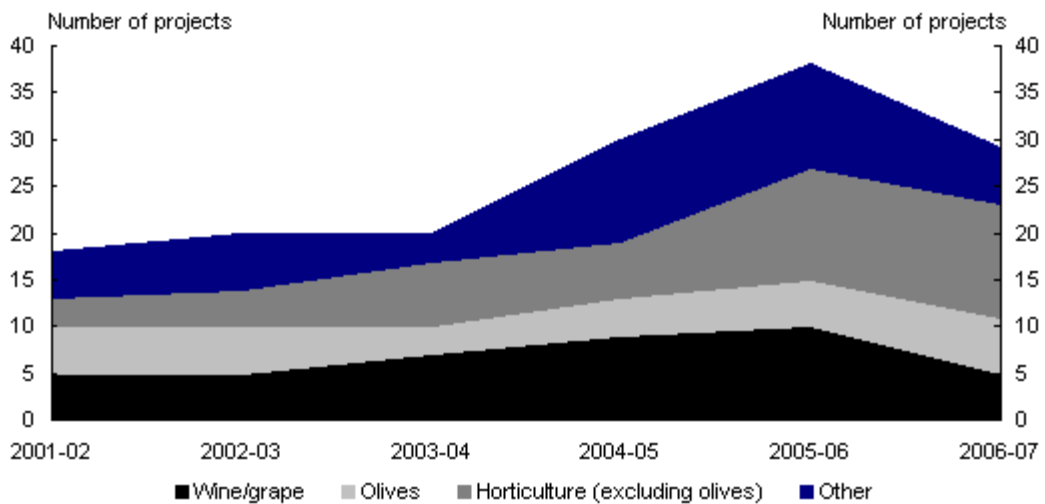
Source: AAG.

Chart 2: Amounts contributed to non-forestry MIS

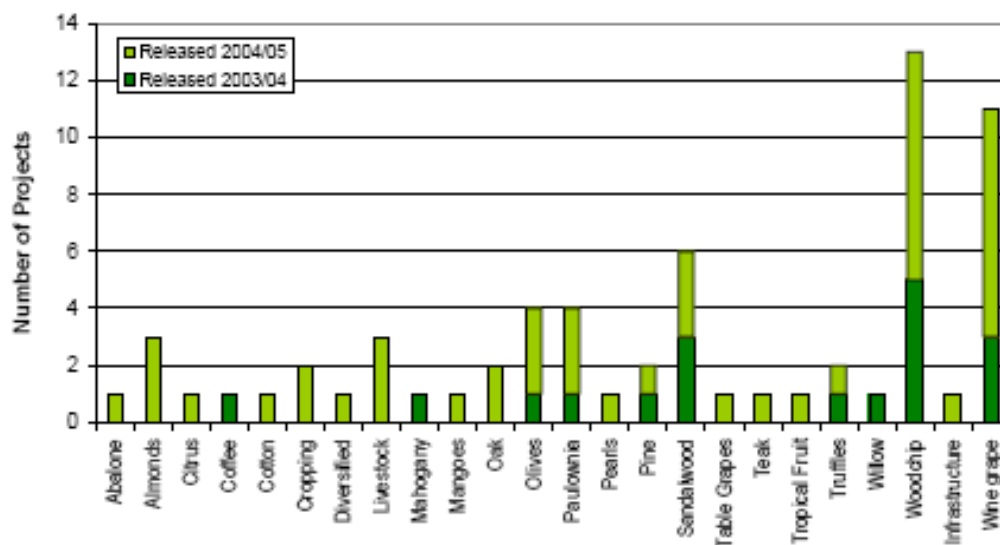


Source: AAG

Chart 3: Number of new non-forestry MIS projects



Source: AAG



Source for figures: Australian Agribusiness Group (Agribusiness MIS Industry End-Of-Year Round Up Report) for July 2005

NOTE: That ‘Horticulture’ in fact includes almonds, olives and grapes (wine and table).

Whether MIS investors should be defined as “passive investors” is currently the subject of a test case in the Federal Court between the Australian Taxation Office and Agribusiness Investment Managers Australia (AIMA).

There are examples within the industry of MIS structures, fees and costs that are overly focused on tax effectiveness. Traditionally, the farm sector incurs costs on an ongoing, even regular, basis. Whatever the outcome of the Federal Court case, HAC is of the view that disciplines (in regard to upfront pre-payments of input costs) need to be established for MISs to shift the focus from tax effectiveness to commercial viability.

There are also some concerns about some MIS operations from the perspective of disclosure and performance against regulatory requirements. A report by the Australian Securities and Investment Commission (ASIC) on Primary Production MISs in 2003 raised a number of issues about the operations of such schemes. The report stated ASIC was concerned:

“... about the quality of advice and disclosure in relation to the promotion of tax-effective mass-marketed schemes in the primary production managed investments sector. In particular ASIC is aware of: the questionable commerciality of some schemes; at times, the poor quality of absence of adequate disclosure; occasional inappropriate or misleading advice; and payment of high commissions ...”

Noting that some reforms have already been implemented to address ASIC’s concerns, HAC believes the focus on these areas should be ongoing.

Growers, and their Peak Industry Bodies, have for some years made representations to HAC about the perceived impact of MISs on their industry and communities. Concerns raised include:

- ❖ Our market signals are being distorted:
 - Oversupply of certain commodities, leading to exacerbation of 'boom and bust' cycles (eg the 'wine lake'; olives in the future?)
 - Competition for scarce resources
 - Land (resulting in artificial raising of prices or 'land-grabs')
 - Water
 - Labour (particularly seasonal labour, which is already at crisis point in many regional communities).
- ❖ Targeting of industries with high up-front expenses for maximum tax benefit (eg vines and tree crops).
- ❖ Inflated establishment costs versus 'real world' grower costs.
- ❖ Transfer of agricultural capital away from proven and viable industries, into others which may have dubious profit potential.
- ❖ The impacts (social, environmental and economic) on many of our rural and regional communities.

To better understand the impact of MISs on horticulture specifically, HAC participated in a review of MIS in horticulture which was undertaken in 2007 by Econtech and Hassall and Associates. The project was jointly funded by AIMA and Horticulture Australia Limited (HAL, the research and development company for Horticulture. This review found that the information available suggested:

"MIS have had important positive impacts on the horticulture industries in which they operate and on the Australian economy as a whole. ... While this report found that MIS have made positive contributions to many horticultural industries, there have also been some negative impacts. In particular increased demand by MIS projects may have increased the price of inputs, such as water, capital and services at a local level."

The benefits that the research identified were in the areas of job creation in regional Australia and in the horticultural sector.

The costs were in increasing demand for some assets and services (such as water and labour); as well as the potential for supply-side pressures on commodity markets.

One of the main conclusions to be drawn from the Econtech and Hassall report is that MIS companies need to integrate better into the industries and the communities in which they operate, in order to maximise the advantages and minimise the costs associated with this form of investment.

Historically, in horticulture at least, MIS operators have not devoted sufficient resources to being transparent and working constructively and cooperatively with other producers and with local communities. Recently, some MIS companies have made efforts to address this situation (the Almond industry is one example of how both the traditional and corporate growers can work collaboratively for the greater good of the industry).

Others MIS companies have not and continue to garner strong criticism (such as negative community and industry response to the planting this year of MIS chardonnay wine grapes).

To ensure their impact on rural and regional communities are understood and well managed, MIS companies should be required to demonstrate a high level of performance in the areas of social, environmental and economic impact. In line with community expectations, this triple bottom-line reporting could be achieved through public reporting from the MIS operator as to its performance in these areas to accompany their annual financial reporting obligations.

Recommendations:

HAC welcomes corporate investment in horticulture in order to help sustain and grow a vibrant horticultural sector in Australia. Therefore, we seek to ensure that investors in horticultural MISs participate based on the long-term commercial viability or profitability of the projects, and are not purely motivated by tax incentives.

HAC therefore recommends that:

- ❖ Should the Federal Court find in favour of the ATO position (that investors in MIS are passive in nature), this finding should be respected by all MIS companies involved in Horticulture.
- ❖ Should the Federal Court not find in favour of the ATO, a process must be established to address concerns about the structure of some MISs.
- ❖ If MISs are to continue, then measures must be introduced to ensure that investments are based on commercial viability, and are not simply tax motivated; and that there are guidelines and disciplines put in place, regarding fees and costs, to address this.
- ❖ Companies operating MISs should make greater efforts to integrate with the industries and communities in which they operate. MIS operators should be required to report on the social and environmental performance of their projects as part of annual triple bottom-line reporting.