

# Fresh start for Agri-schemes

In the bad old days, agribusiness investments were mainly regarded as a source of highly-g geared tax deductions. It's goodbye to all that. The ATO's product ruling system means you only get a dollar's deduction for a dollar's investment, and the focus now is on the underlying quality of the investment.

The tax-advantaged agribusiness sector offers ethical investors the opportunity to add diversity and flexibility to their investment portfolios – ideally with spin-off benefits to the environment or regional communities as well.

Diversification is widely regarded as a good thing in investment. The investor with a spread of assets has a better chance of achieving steady returns, because when one class of assets is experiencing a downturn (as did shares last year), other assets may soften the impact by performing well (as property trusts did last year).

Although they are not generally considered a separate asset class, managed investments in the agribusiness industry do have very different return characteristics from mainstream assets such as shares and bonds, and can therefore provide diversification opportunities for investors.

ment structure than a unit trust or managed fund. In a unit trust, the investment is considered a capital item, and the investor's capital plus interest are returned in the future, minus any capital gains tax. Any tax advantages can only be enjoyed once the investment is redeemed.

By contrast agribusiness investments can deliver the tax advantages up-front.

"So, not only are you getting the opportunity to invest in a different sector, giving diversification, it's also an investment in a differently-structured asset because it's not a capital item," she says.

## TAX-DRIVEN OR INVESTMENT-DRIVEN

Critics of agribusiness investment schemes, including David Marshall of specialist research firm van Eyk Capital, argue that in marketing

these projects agribusiness managers put too much emphasis on the fact that they have received a product ruling

by the Australian Tax Office. The concern is that unsophisticated investors may mistake the ruling as an ATO endorsement of the fundamental quality of the agribusiness's assets and investment prospects. In fact, the ATO's product rulings only relate to tax deductibility (see box).

Guilford concedes that the existence of a product ruling does play a big part in Timbercorp's marketing strategies. She says the emphasis on product rulings is designed to educate the investing public.

"The problem has been that there is a misunderstanding in the market. People don't realise that product rulings have only come out in the last few years," says Guilford.

Last year the Tax Commissioner revoked the positive tax status of some investment schemes, causing public outcry and a Senate inquiry, but this action concerned tax rulings that were made prior to the product ruling system coming into effect.

Guilford says many people are unaware that the current product ruling system does provide investors with tax certainty because the decision is binding on the Commissioner, as long as the investing company does what they say they're going to do.

"Some firms may have pushed [the meaning of an ATO Product Ruling] to imply financial viability, but we say 'do your own numbers, you have to go to the independent research houses and do your own assessment, or speak to financial advisor's,'" says Guilford.

The environment for the managed investments industry has been difficult lately, particularly because of the pace of regulatory reform says managing director of Willmott Forests, Marcus Derham.

"The managed investment arena has been subjected to more regulatory changes in the last four years than I've experienced over the 16 years I've been in the industry."

"The playing field has been changing. What I'm seeing at the moment is a flight to quality. Investors are looking at the companies that have been around for a while that have a positive record of success and those that haven't been way-out on projections of their future returns," he said.

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In agribusiness the investment is in production of a crop, be it forestry, almonds, wine, olives or truffles. The cost of establishing the crop is an expense and therefore the investor gets tax deductions against other taxable income earned in the same year as the expense was incurred. Any future income earned from harvests is then considered taxable income.

Bonnie Guilford, marketing and technical manager for listed agribusiness promoter Timbercorp, says this is quite a different invest-



## WHAT IS AN ATO PRODUCT RULING?

**The Australian Tax Office (ATO) began issuing product rulings in 1988 as a way to curb the increasing range of investment schemes that were being promoted on a tax-effective basis. Cheryl-Lea Field, assistant commissioner for small business at the Tax Office, says the problem was that not all of these schemes had obtained specific rulings.**

"For individuals there are private rulings which are binding if granted, but they only cover that individual. There was some confusion early on that a private ruling was also available to other people in similar investments or the same investment - but this isn't the case."

"Today's product rulings overcome this problem by providing tax certainty to any, and all, investors in a managed investment fund that has been granted a ruling on its scheme," she said.

Product rulings not only relate to specific schemes, for a specific duration, they're also dependent on the achievement of specific development objectives by the scheme's management. "If a promoter doesn't actually carry out the particulars of the project as specifically addressed in the product ruling then the ruling can be withdrawn and the tax deductibility associated with the project will be lost.

"We encourage investors to read the product ruling and understand what the investment arrangement is that the promoter has signed up to. Then they should make regular reviews to actually make sure the promoter is carrying out the procedures in accordance with the product ruling," says Field.

The ATO is quick to point out that product rulings are no assurance of commercial viability, or whether or not the fees and charges associated

with the investment are reasonable or represent industry norms. Nor do product rulings give assurance that the projected returns of the project are achievable and reasonably based.

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"Investors should also look at the period the ruling is actually valid for, particular coming up to June 30. It's possible that a product will reach the end of its shelf life and even though the new investment product may be materially no different from that which was covered previously, the ruling is still out of date. Without a valid ruling the new investments will not be deductible," says Field.

"There is no such thing as 'pending' or 'applying for'. If promoters don't actually have a product ruling at the time of the investment then tax advantages won't be valid.

"Investors should have no problems at all of getting a copy of the product ruling from the investment provider and we encourage them to ask for it. If not, all product rulings that have been granted are listed on the ATO website," she says.

Managed investment companies would find it virtually impossible to operate these days without a product ruling, said Derham, but they're not the be-all-and-end-all. One crucial thing that investors need to know is whether the manager actually has the ability to carry out the business in accordance with the product ruling. If they don't, the product ruling becomes meaningless, because it will be withdrawn.

Investors examining the financial prospects of an agribusiness should concentrate on the ability and experience of management as well as its operating environment according to Shane Kelly, managing director with the independent ratings agency Agribusiness Research.

"The key area for investors to examine is management. How much experience does the project manager have and how relevant is it to this particular agribusiness? How good is their past performance?

"The second key area is markets. What is the likelihood that the project manager will be able to find a market for the end product be it timber, grapes, wine or olives? Is the marketing plan domestic or export focused? What are the

### AGRIBUSINESS COMPANIES HELD BY AUSTRALIAN ETHICAL FUNDS

COMPANY ETHICAL FUNDS	
Auspine	Australian Ethical Equities Trust and Large Companies Share Trust
Paperflinx	BNP Paribas Ethical Fund, Glebe Blue-Chip Equities Trust
So Natural Foods	Australian Ethical Equities Trust
Timbercorp Limited	Equity Trustees - Australian Ethical Equity Fund, Hunter Hall Australian Value Trust
Source: Corporate Monitor	

trends taking place in this market, and if the company is value adding or marketing it themselves, do they actually have the specific experience to do this?

"An investor should also examine the key assumptions that underpin yield, quality and performance targets. Are they realistic and can this management team achieve them? This can involve checking the site location and seeing whether it's suitable for the type of crop that's being grown," says Kelly.

"Investors would also do well to take into account the scale of the project because this could impact on the fee structure involved with the investment. It is important to know the percentage of investor funds that make it to the actual project, rather than going to commissions, administration, legal and other fees," he says.

"In some cases you can have less than 50 cents in the dollar going into the project," he said.

At the other end of the scale are small scale niche projects such as private vineyards. The costs and fees associated with these projects are lower but don't suit all investors as minimum investment amounts are often in the region of half a million dollars.

Agribusiness Research also provides analysis of the ethical aspects of agribusiness investments, taking a triple-bottom line approach that not only looks at environmental management but the way the project fits in with the wider community and government.

"There are a few projects that are taking over

uncleared or native areas of vegetation. More often than not it's one mono-culture for another. Soil care, chemical and water use and pollution are all important. The key issue is long-term sustainability of the business," says Kelly.

As with any investment it's important to take your time, Kelly says. Because at any one moment there are generally a number of suitable investments to choose from. Consulting a qualified and experienced financial planner or investment adviser that has an understanding of your ethical investment needs is recommended.

Financial advisers have access to, specialised research and ratings on the sector, often sold by subscription to the financial planner's dealer group or franchise. If consulting an adviser, however, the investor must inquire what fees and commissions are involved, including those going to the adviser.

At the Financial Planners Association National Convention in Brisbane in mid-November last year, David Marshall of van Eyk Capital cautioned financial planners about the relatively high management fees in many current agribusiness prospectuses – including many of those that have received a product ruling (which Marshall terms "de facto marketing approval") from the ATO.

Marshall also questions the comparatively low yields on offer given the high degree of risk being taken in many agribusiness schemes.

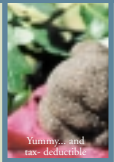
Marshall argues many agribusiness schemes have a similar level of risk as venture capital and investors should expect to earn a com-



mensurate risk premium on their investment, but the yields on offer do not reflect the risk being taken.

An "Advanced Taxation Strategies" conference will be held in Sydney on March 25-26, organised by Resnik Communications. Targeted at financial advisers, accountants and other investors wishing to evaluate agricultural schemes, the conference will present ratings of the various agricultural investments from several research houses as well as contrasting views on how these schemes compare with other tax-effective forms of investment. ☺

## TASMANIAN TRUFFLE ENTERPRISES LTD



Tasmanian Truffle Enterprises is a managed agribusiness investment that aims to be Australia's first commercial producer of French Black Truffles according to company director, Frank Cassells.

"Tim Terry, managing director of the project, grew the first black truffle in Australia back in 1999," he said.

The French Black Truffle is a fungus famous for its use in cooking. The truffle has been described as 'heaven sent', because of its unique aroma which

adds a delicate flavour to veal, stuffed capons, and turkeys, fillets of beef, omelettes, shellfish and fine saucés.

The company will harvest the truffles in the Australian winter which will allow them to be imported into France when the local crops are out of season. The initial cost of an investment parcel is \$8,745 including GST. Each grower will hold a lease over 0.1 hectare which will give them a minimum of 40 trees to grow Truffles. The annual lease fee is \$220. The grower is able to appoint TTEL to manage their Trufferie, for which the grower will pay annual management fees of \$880.

According to the prospectus, proceeds from the sale of produce are forecast to commence in

2007 and continue each year until completion of the project in 2015. It is estimated that growers should be cashflow positive in 2008.

It's forecasted that on completion of the project, each grower will have received \$78,412 per Trufferie, for a net return of \$49,353 per Trufferie after deducting all expenditure including the initial application fees. This represents an internal rate of return (IRR) of 15.9 per cent on the initial investment.

Investors who invest in the project by April 8th, 2002 are covered by Product Ruling 2001/169. The product ruling guarantees approximately 80 per cent deductibility for an initial investment in the TTEL scheme, according to managing director Tim Terry. ☺