

# INVESTMENT MARKETS AND SUSTAINABLE AGRICULTURE; A CASE FOR ECOLOGICAL TAX REFORM.<sup>1</sup>

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This paper considers the outcome of recent inquiries into mass-marketed tax effective investment schemes in Australia within the broader context of promoting ecologically sustainable development in the agribusiness sector. The recent inquiries have revealed some significant shortcomings in the application of the self-assessment system to agribusiness investors, which have to some extent been remedied by the introduction of product rulings. Whilst product rulings have provided investors with a certain degree of security, there has been a significant decline in agribusiness investment and a convergence in the range of agribusiness ventures being offered. The author concludes that the income tax system is currently providing the wrong market signals, by promoting many agribusiness investment schemes that are not ecologically sustainable. Accordingly, there is a strong case for ecological tax reform, whereby the taxation treatment of agribusiness investment schemes needs to be better integrated with environmental policy.

## INTRODUCTION

Perhaps the most influential feature of the Australian income taxation system over the last 20 years has been constant change. Successive waves of tax reform by Federal governments have produced several new tax bases and ever-increasing complexity and volume in our tax laws, which have presented immense challenges for taxpayers and tax administrators alike. One of the key administrative responses to this challenge was the introduction of 'self-assessment' in 1986, which effectively reversed the roles of taxpayer and tax administrator and relieved the tax administrators of primary responsibility for interpretation of the law. Whilst self-assessment has eased the regulator's burden, it has cast a considerable technical

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compliance burden upon taxpayers and tax advisers. Some unhappy consequences of this new burden were vividly revealed by several recent inquiries into certain 'mass marketed tax-effective investment schemes'.<sup>3</sup>

The schemes in question resulted in over 700 complaints being made to the Commonwealth Tax Ombudsman and ultimately caused substantial financial harm to more than 40,000 investors for whom tax deductions of over \$4 billion were disallowed from tax years 1995-96 to 1999-2000.<sup>4</sup> The inquiries revealed that the majority of investors were 'ordinary; Australians who considered themselves to be law-abiding taxpayers. The deductions in dispute were effectively determined by a series of 'test cases' that have largely affirmed the Australian Taxation Office ('ATO') position on the law relating to the schemes, including the application of the general anti-avoidance rule Part IVA.<sup>5</sup> The ATO has also considerably strengthened its management of such schemes through a range of new strategies, including the introduction of 'product rulings' in 1998. A range of 'financial services reforms' has also strengthened the regulation of the managed investment industry by the Australian Securities and Investment Commission ('ASIC').<sup>6</sup> One consequence of these developments is that the volume and variety

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3 Commonwealth Ombudsman (1999) 'The ATO and Budplan; Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Budplan'; June 1999, Commonwealth Ombudsman (2001) 'The ATO and Main Camp; January 2001 Commonwealth Ombudsman (2001) 'Report on investigation of a complaint by a promoter of a series of films; February 2001; Senate Economics References Committee (2002) *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection* (Final Report, Feb 2002); Australian National Audit Office (2004) *The Australian Taxation Office Management of Aggressive Tax Planning* (Audit Report No 23 of 2003-2004).

4 Senate Economics References Committee (2002) cited above, at para 1.17 (Table 1). See also Michael O'Neill (2001) 'Taxes Death and Civilisation; A Look at Year End Products' A Speech by the Assistant Commissioner of Taxation to the Taxation Institute of Australia at Brisbane, 15 May 2001 – online at <http://www.ato.gov.au/print.asp?doc=/content/sp200103.htm> (accessed 18 March 2004).

5 In particular, see *Howland-Rose & Others v Federal Commissioner of Taxation* (known as the 'Budplan') 2002 ATC 4200 (Conti J, 18 March 2002); *Vincent v Federal Commissioner of Taxation*, 2002 ATC 4490 (French J, 24 May 2002) and 2002 ATC 4742 (Full Federal Court, 16 September 2002), *Puzey v Federal Commissioner of Taxation* [2002] FCA 1171 (Lee J, 19 Sept 2002) and [2003] FCAFC 197 (Full Federal Court, 26 August 2003); and *Sleight v Federal Commissioner of Taxation* [2003] FCA 896 (Nicholson J, 26 August 2003).

6 See Ch 5C of the *Corporations Act* (Cwth).

of agribusiness investment schemes on offer have contracted greatly and the market has become largely confined to a somewhat smaller number of schemes which can meet the demands of both the ATO and ASIC.

This article considers the taxation and regulatory framework for agribusiness investment schemes in Australia within the broader context of promoting ecologically sustainable development in the agribusiness sector. Part 1 reviews the recent history of tax reforms and the establishment of the self-assessment system. Part 2 considers how self-assessment may have contributed to the recent problems faced by investors in the agribusiness sector. Part 3 looks at responses to these problems, such as the introduction of product rulings and other recent improvements to tax administration. Part 4 considers the broader environmental outcomes of the recent developments in agribusiness investment schemes. The article concludes with some observations on the potential for 'greening' the tax administration system, with suggestions of a mechanism for ensuring that schemes that attract taxation concessions are ecologically sustainable.

## TAX REFORM AND THE SHIFT TO SELF-ASSESSMENT

Continual tax reform is now the norm. This phenomenon gained momentum in the late 1970s when a range of anti-avoidance rules were introduced to deal with a range of particularly blatant and sometimes highly and artificial tax avoidance arrangements, including measures to deal with fraudulent schemes (including the notorious 'bottom of the harbour' schemes<sup>7</sup>). This period also resulted in the introduction of a range of new criminal offences for tax evasion in 1980 and a more powerful general anti-avoidance rule in 1981. Thereafter tax reforms have generally originated from a series major inquiries and reviews over the last 20 years, which have generally sought to broaden the income tax base, including:

(1985) The Hawke/Keating Government's Tax Summit;

- capital gains taxation
- fringe benefits taxation
- substantiation of work related expenses
- imputation of company tax
- foreign tax credit system reforms; and

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<sup>7</sup> See the *McCabe-Lafranchi Report* (1978-81) and the *Costigan Royal Commission into the Painters and Dockers Union* (1981).

- (partly as a response to the above) self assessment

(1988) Review of Foreign Source Income;

- extensive international tax reforms (including accruals tax);

(1998) Howard Government's New Tax System:

- major reform of Commonwealth-State fiscal arrangements;
- the goods and services tax ('GST');
- the Australian Business Number; and
- integration of tax collections systems (the Business Activity Statement etc)

(1999) The Ralph Review of Business Taxation:

- various 'integrity' measures (specific anti-avoidance rules);
- the CGT discount
- expansion of CGT small business concessions
- consolidation of corporate groups

These reforms have generally been reactions to changing political and economic circumstances, such as rapid economic growth in the 1970s and 1980s, and more recently, the increasing deregulation and globalization of business and investment markets, the emergence of electronic commerce. It has also been influenced by the 'rationalisation' of many business enterprises, including many former state owned enterprises, which has prompted widespread moves away from traditional employment arrangements to increasing use of contractors and consultants. Broadly speaking, over the last 30 years the income tax legislation has evolved from a traditional narrow based model with strong reliance on specific anti-avoidance measures, to a far more sophisticated broad based model, with more extensive specific anti-avoidance rules, a far stronger general anti-avoidance provision, and a range of linkages between specific taxation systems (such as GST, FBT).

The task of the ATO has changed immensely during this transition. Before the introduction of self-assessment on 1 July 1986, there was a positive obligation upon the Commissioner to assess tax liability. Thus taxpayers were obliged to lodge a

comprehensive taxation return, containing enough information to enable the ATO to carry out the necessary assessment. In practice many taxpayers (usually through their tax agents) prepared exhaustive returns with lengthy attachments providing explanations to justify positions taken in the return (particularly corporate entities). This situation changed dramatically with the introduction of 'self-assessment', whereby the Commissioner was permitted to accept 'a statement' in a tax return for the purpose of ascertaining a taxpayer's tax liability.<sup>8</sup> Thus the ATO was immediately relieved of the obligation to fully assess each tax return and taxpayers were only required to state the bare essentials to establish their tax liability. The responsibility for the correctness of a tax return now rested squarely upon taxpayers. This was supported by rigorous substantiation rules which required taxpayers to retain documentary evidence to support deduction claims and very strong penalties for understatements of tax liability. On the other hand, the role of the ATO changed from administrative assessment of returns to post-assessment review of tax returns, based upon an expansion and refinement of audit activities, including computer-assisted data matching systems.

The inquiries into mass marketed schemes suggest that this reversal of roles under self assessment was not well understood by taxpayers. They also reveal that the role and responsibility of tax advisers was not well recognised. Self assessment assumes that taxpayers have a complete knowledge of the taxation law in order to duly comply with their taxation obligations. This was a very onerous obligation at a time when many complex new legislative schemes had been introduced in fundamental areas such as capital gains, fringe benefits and the substantiation of deductions. Tax advisers could obviously assist on interpretation needs, but the laws were complex and advisers could also get it wrong. Clearly, taxpayers needed a robust mechanism to obtain guidance from the ATO in areas of technical uncertainty. Thus the introduction of self assessment inevitably led to the development of a reliable taxation ruling system.

### **Genesis of the ruling system**

The Australian Taxation Office has had a long standing internal system for circulating interpretive decisions amongst its own staff, but only a limited amount of this information (eg depreciation rates) was made publicly available.<sup>9</sup> The first

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<sup>8</sup> s 169A(1) *Income Tax Assessment Act 1936*.

<sup>9</sup> A more detailed history of the ruling system can be found in the recent report of the Australian National Audit Office (2001) *The Australian Taxation Office's Administration of Taxation Rulings* (Audit Report No 3, 2001-2002), at Appendix 1 – 'Background and History of Taxation Rulings'.

major step in disclosure of these internal interpretive decisions came in 1982, when the *Freedom of Information Act 1982* required the Commissioner to release documents used by his staff in making decisions on the application of the taxation law. The Commissioner responded by establishing two formal systems of taxation rulings freely available to the public, designated as Income Tax Rulings ('IT') and Miscellaneous Tax Rulings ('MT'). This early ruling system did not have any legislative foundation but it enabled the ATO to adopt a more consistent approach to communicating its interpretation of tax laws. Taxpayers were warned that these rulings were only the Commissioner's interpretation of the law and that they did not 'supplant the terms of law'; therefore the courts could overturn them.<sup>10</sup> A further clarification of the effect of this system was made in 1988, by ATO ruling IT 2500.<sup>11</sup> This general ruling distinguished between taxation 'rulings' that provide guidelines for the public and ATO staff in relation to the interpretation and administration of income tax law; and 'advance opinions' which give responses to specific requests from taxpayers seeking advice as to the income taxation consequences of a proposed transaction. It also reassured taxpayers that rulings were 'administratively binding'. This meant that the Commissioner was prepared to stand by a ruling and would only depart from it where there were good and substantial reasons.<sup>12</sup> It may be noted that there may be some tension between this concept and a long held principle that the Commissioner cannot be estopped from assessing in accordance with the law; *FCT v Wade* (1951).<sup>13</sup> Nevertheless, the administrative ruling system generally made the ATO more accountable to the

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10 Income Taxation Ruling No.1 (IT1) (which explains the system of issuing taxation rulings) states:

*A taxation ruling will issue in respect of any decision which satisfies the following criteria:*  
 (a) provides an interpretation, guideline, precedent, practice or procedure to be followed in making a decision that affects the rights or liabilities of taxpayers;  
 (b) establishes a new or revised interpretation of our administration of the tax laws; and  
 (c) affects all taxpayers or a selection of the tax-paying community, i.e., not simply an individual instance.

11 This ruling implemented various recommendations of the Senate Standing Committee on Legal and Constitutional Affairs investigation into the nature, function, ambit and adequacy of taxation rulings issued by the ATO, and the process by which the rulings are prepared and distributed. The Committee's report was tabled in Parliament on 5 November 1987.

12 Such as legislative changes, a contrary tribunal or Court decision, or where the ruling is otherwise no longer considered appropriate; IT2500.

13 High Court of Australia; (1951) 84 CLR 105.

public and gave taxpayers some greater confidence that ATO decisions were internally consistent.<sup>14</sup>

However, when the self assessment legislation was introduced in 1986, it was belatedly realised that the existing administrative ruling system could not provide the type of guidance needed, where taxpayers with widely different circumstances would have a multitude of specific requests. A hasty amendment was inserted which enabled taxpayers to raise a question relevant to their tax liability when lodging their return.<sup>15</sup> Unfortunately this limited request provision had several practical shortcomings. In particular, it merely required the Commissioner to consider the question, and provided no requirements or time frame for a response. It was also realised that the self-assessment regime was inconsistent with the existing penalty system based on the concept of 'false or misleading statements' (which were more relevant to the former administrative assessment regime under which taxpayers were obliged to make 'a full and true disclosure'). These and other structural problems led to a major review of self-assessment, which was announced late in 1990. Following a period of industry consultation, a comprehensive new ruling and penalty system was introduced from 1 July 1992.<sup>16</sup> The new system introduced:

- (1) a comprehensive new system of legally binding 'private rulings' whereby taxpayers could make a request to obtain the Commissioner's written opinion on how the law would apply to a specific situation;
- (2) a new system of legally binding 'public rulings' to provide for more general statements of interpretation applicable to general classes of transaction or taxpayers;

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14 There are several categories of public ruling that the ATO continues to maintain on an administratively binding basis; (1) Published rulings on procedural, administrative or tax collection matters – being rulings on the administration of the taxation system, dealing with procedural, administrative or tax collection matters and any part of a TR or GST public ruling that deals specifically with such matters. (2) Rulings on liability issues under a tax law outside Part IVAAA of the TAA. This includes areas such as superannuation, and used to include the Child Support Agency. These are included under the various ruling series such as: Miscellaneous Taxation Rulings (MT); Superannuation Contribution Determinations (SCD); Superannuation Contribution Rulings (SCR); Superannuation Guarantee Determinations (SGD); and Superannuation Guarantee Rulings (SGR).

15 See s 169A(2) *Income Tax Assessment Act 1936* and IT 2616 which provided administrative guidelines for provision of such advice.

16 *Taxation Laws Amendment (Self-Assessment) Act 1992*.

- (3) a new system for review of private rulings by the Administrative Appeals Tribunal or a court;
- (4) a comprehensive new penalty system ('tax shortfall penalties'); and
- (5) consequential changes to objection rights, interest payments, lodgement of election notices, and self-amendment processes.

The new system was also made more universal, being applicable to income tax, Medicare levy, withholding taxes, franking deficit tax and FBT.

### **Binding private rulings**

The new system defined a 'private ruling' as 'a ruling', in response to an application by a person (the 'rulee') to the Commissioner, 'on the way in which, in the Commissioner's opinion: ... a tax law or tax laws would apply to the person in respect of a year of income in relation to an arrangement'.<sup>17</sup> Thus private rulings enable taxpayers to request a ruling on an uncertain area of the law before the assessment process was complete. The Commissioner must provide a private ruling on the matter within a certain time frame, except where:

- an existing private ruling covers the matter;
- the matter has been decided by an assessment;
- the matter will be decided by a tax audit being carried out;
- the application is frivolous or vexatious, or the rulee does not seriously contemplate the arrangement in question;
- the rulee has not given sufficient information; or

it would be unreasonable to comply with the application.<sup>18</sup>

Upon receipt of a private ruling, taxpayers are not bound to follow the ruling in preparing their returns, but penalty tax may apply if there is a tax shortfall where a taxpayer has not followed a private ruling. If the taxpayer is dissatisfied with a private ruling he or she may object against the ruling in similar fashion to an objection against an assessment. If an unfavourable objection decision results, then the rulee may then seek review of the objection decision by the AAT or appeal to the Federal Court against the decision.

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<sup>17</sup> See Part IVAA *Taxation Administration Act 1953* s 14ZAF.

<sup>18</sup> Part IVAA *Taxation Administration Act 1953*, ss 14 ZAM and 14ZAN.



From 1 July 2000, the Government has extended the private ruling system by introducing a system of binding oral rulings based on specific oral advice provided by the ATO.<sup>19</sup> In general, oral rulings are only issued to non-business taxpayers with relatively simple income tax affairs, and only in relation to simple inquiries. An oral ruling can only be challenged by first seeking a private ruling on how the law applies to the matter. From February 2001 the ATO has also introducing a new ruling series called ATO Interpretive Decisions ('ID') which publishes private ruling decisions which have been suitably edited to conceal the identity of parties.<sup>20</sup>

### **Binding public rulings**

A 'public ruling' is defined as a statement of the Commissioner's opinion on the way in which a tax law would apply to:

- any person in relation to a class of arrangements;<sup>21</sup>
- any class of persons in relation to an arrangement;<sup>22</sup> or
- any class of persons in relation to a class of arrangements.<sup>23</sup>

The major enhancement of this new ruling system is that after 1992 taxation rulings became 'legally binding' on the Commissioner, meaning that in the event of a change in the law, or the ATO interpretation of a particular matter, the taxpayer is protected in respect of what he or she has done up to the date of that change. This protection is specifically provided for by limitations on the Commissioner's power to amend assessments.<sup>24</sup> It should be noted that taxpayers may have grounds to disagree with the Commissioner's interpretation in a public ruling, and they are not bound to follow public rulings in preparing their tax returns. A new series of public rulings was commenced under these rules, referred to as the 'TR' series, to distinguish it from the earlier IT series of administrative rulings. The

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19 Enacted under Div 360, contained in Schedule 1 of the TAA.

20 Based on recommendations of a report by Tom Sherman (2000) 'Report of an Internal Review of Procedures relating to private Binding Rulings and Advance Opinions in the Australian Taxation Office'.

21 s 14ZAAF

22 s 14ZAAG

23 Part IVAAA of the TAA 1953.

24 See ss 170BA and 170BB of *Income Tax Assessment Act 1936*.

Commissioner has also created a new series of public rulings that dealt with smaller, more specific issues, called 'taxation determinations' (the 'TD' series).<sup>25</sup>

The 1992 self-assessment reforms also introduced a new penalty regime, which introduced 'culpability' penalties, which may apply if there is a tax shortfall, where the taxpayer has not taken exercised 'reasonable care' or did not have a 'reasonably arguable position' on a particular issue, or where the position taken is contrary to a private ruling.<sup>26</sup> This penalty framework is far more consistent with self-assessment, as it recognises that there is considerable uncertainty in our tax laws, and accordingly that taxpayers should not be penalised where they have made a conscientious attempt to fulfil their tax obligations.

More recently, the public ruling system has been enhanced by the introduction of 'product rulings' in 1998 (discussed below). From 28 February 2001 a new type of ruling, known as 'class rulings' was introduced, designed to meet a need to provide rulings to people in circumstances that were not readily met by the established private rulings system.<sup>27</sup> Class rulings provide legally binding advice in response to a request from an entity seeking advice about the application of the tax law to a large number of persons in relation to a particular arrangement

## SELF-ASSESSMENT AND MASS MARKETING INVESTMENT SCHEMES

Various aspects of the self assessment system have been regularly considered in a series of other reviews and reports over the last decade, including the Joint Committee of Public Accounts (1993)<sup>28</sup>, the ANTS Report (1998)<sup>29</sup>, the Ralph Report

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25 Since 1992, the three further series of public rulings have been created. These are Goods and Services Tax Rulings (GSTR); Product Rulings (PRs); and Superannuation Guarantee Rulings (SGRs). GST public and private rulings have their legislative foundation in s. 37 of the *Taxation Administration Act 1953* and there are significant differences between GST private and public rulings and other public and private rulings.

26 The shortfall penalty rules are now found in Division 284 in Schedule I of the *Taxation Administration Act 1953*.

27 See Class Ruling CR 2001/1.

28 Joint Committee of Public Accounts (1993), *Report 326: An Assessment of Tax*. The main conclusions of the JCPA on the rulings system were that the Commissioner needed to be more accountable for rulings, and that the fundamental status of rulings as 'simply the Commissioner's view of the law' needed to be affirmed.

29 Commonwealth of Australia (1998) *Tax Reform: Not A New Tax A New Tax System*, which stated the Government's intention for the rulings system to be made more

(1999)<sup>30</sup>, the Sherman Report (2000)<sup>31</sup>, the House of Representatives Standing Committee on Employment, Education and Workplace Relations (2000)<sup>32</sup>, the Senate Economics References Committee ('The Senate Committee Report')<sup>33</sup> and the Australian National Audit Office (2001) and (2004)<sup>34</sup>. This process is on-going, with a recent announcement that yet another review of self-assessment is to be commenced in 2004.<sup>35</sup> This continual investigatory activity surrounding self assessment suggests there are continuing problems with the system despite the substantial improvements in 1992. In particular, the outcome of the inquiries into mass-marketed schemes show that self-assessment system was not effective in preventing an almost unprecedented episode of wide scale tax avoidance.

The Senate Committee Report found that overwhelmingly, participants in the schemes '... had prided themselves on being, 'good' taxpayers.'<sup>36</sup> It also found that the majority of taxpayers did not understand the implications of self-assessment,

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comprehensive and its scope more certain. The Report also stated that the Government would examine a system of user charges for private rulings and other binding advice given to large business taxpayers in complex cases.

30 Ralph Committee (1999) *Review of Business Taxation: A Tax System Redesigned* made recommendations on taxation rulings similar to those outlined in ANTS

31 Tom Sherman (2000) 'Report of an Internal Review of Procedures relating to private Binding Rulings and Advance Opinions in the Australian Taxation Office'. This Report made 13 recommendations to improve the integrity and transparency of the private rulings system.

32 This committee made a number of recommendations regarding the application of the ruling system to employee share plans.

33 Senate Economics References Committee (2002) *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Final Report, February 2002 (the 'SERC Report'); The inquiry was established on 29 June 2000 to investigate: measures designed to promote investor understanding of the financial and taxation implications of tax effective schemes; adequacy of measures for controlling tax effective scheme designers, promoters and financial advisers; and the ATO's approach towards and role in relation to mass marketed tax effective schemes. The Committee also explored the ATO's subsequent dealings with the participants of those schemes, especially regarding its use of the anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936*.

34 Australian National Audit Office (2001) *The Australian Taxation Office Management of Taxation Rulings* (Audit Report No 3 of 2001-2002) and Australian National Audit Office, (2004) *The Australian Taxation Office Management of Aggressive Tax Planning* (Audit Report No 23 of 2003-2004).

35 Commonwealth Treasurer, (2003) *Review of Aspects of the Income Tax Self Assessment* (Press Release No 98/2003).

36 SERC Report para 2.16.

with many accusing the ATO of acting retrospectively, in amending assessments up to six years later, (when in fact self assessment explicitly permits this action).<sup>37</sup> However the Senate Committee Report also reveals that even if the relevant taxpayer had understood the system, they may still have entered the arrangements, as they would have faced great difficulty in establishing that the taxation advice they had relied upon was technically incorrect.<sup>38</sup> Many investors had relied upon 'expert' opinions, and there is continuing support for the correctness of those opinions from some of the top tier of the taxation profession.<sup>39</sup> This difficulty was particularly acute where there was a prospect that Part IVA might apply, as it was conceded by the ATO that the even a ruling could not guarantee immunity from ATO action in Part IVA situations.<sup>40</sup> It was also suggested that the various appeals later decided in favour of the Commissioner were not necessarily conclusive of the legal position, as they were funded by the ATO 'test case program' and the suggestion has been made that some of the least meritorious schemes were selected for funding.<sup>41</sup>

These findings of the Senate Committee reveal at the very least that the interpretation of the taxation laws applicable to mass marketed investment schemes was a formidable task and few investors would have had the skill and experience to dispute the correctness of the taxation advantages promised by scheme promoters. This is more obvious when it is recognised that the vast majority of investors would have relied upon tax agents, accountants, financial planners or other financial advisers to verify these claims. However, it is clear that many of these tax advisers had themselves been persuaded by 'expert' opinions from top tier firms or QCs opinions which supported many of the relevant schemes. Of course, the self-assessment system provides a mechanism for taxpayers to seek a ruling from the ATO on contentious matters. However, in practice, there are several reasons why this option may have been unattractive:

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37 SERC Report para 3.30.

38 SERC Report paras 3.37 and 3.38.

39 SERC Report para 3.12. It was also stated in evidence to the SERC that the ATO had not publicly taken a position contrary to some of the legal opinions supporting and in some instances had provided private rulings, which had become well known on the tax industry 'grapevine'.

40 SERC Report para 3.24.

41 Para 3.43.

- seeking of a ruling usually requires the use of professional tax advisers, which is a time consuming and costly exercise;
- rulings may not be conclusive on some issues, such as the application of Part IVA.
- self assessment system specifically contemplates that taxpayers may diverge from ATO views where they have taken reasonable care, or have a reasonably arguable position (the ATO would not have the resources to provide rulings if all taxpayers sought rulings on all contentious matters); and
- the ATO may be expected to take a pro-revenue stance as a matter of course on contentious issues (to safeguard the integrity of the system);

The various inquiries have found that the ATO handling of some aspects of scheme matters was 'less than ideal'.<sup>42</sup> It should also be pointed out that before most of these inquiries were concluded, the ATO had already taken substantial steps to avoid repetition of the more obvious problems. One of the most successful strategies adopted was the introduction of a system of 'product rulings'.

## THE ADVENT OF PRODUCT RULINGS

Before product rulings were introduced, investors relied heavily upon a promoter's description of the taxation deductions and other consequences of a particular investment. However, if the promoter was wrong, the self-assessment system imposed taxation penalties only upon the taxpayer concerned (ie. the investor). Product rulings were introduced in July 1998, to provide both promoters and investors with greater certainty about the taxation consequences of particular products, before investors make a financial commitment.<sup>43</sup>

Product rulings are typically made at a promoter's request, on the availability of tax benefits claimed to arise from an arrangement (or 'product') in which a number of taxpayers individually enter into substantially the same transactions with a common entity or a group of entities. This was intended to specifically cover products that were mass marketed to the general public through a memorandum or prospectus prepared by a promoter, or offered to individuals by personal

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42 Some particular negative findings included concerns over delays in issuing rulings and amended assessments. It seems that these findings have influenced the 2001 ATO settlement offer for MMIS participants, which provided a significant remission of the penalties imposed on investors.

43 See PR 1999/95 for further guidance on the product rulings system.

invitation (often through accountants and other financial consultants). These products were typically investment opportunities in areas like primary production and agribusiness, and also financial and insurance products, which all usually have the common attraction of providing large up front tax deductions. Product rulings generally differ from other public rulings in the following ways:

- a product ruling is generally initiated by a written application from the promoter or principals carrying out the arrangement (but not the participants);
- product rulings are prospective, being only applicable to arrangements entered into after the date the ruling is made;
- product rulings specify the date they cease to have effect, and will generally not be applicable for more than three years from the end of the income year they are made.

It should be noted that product rulings have only been one part of a concerted government crackdown on mass marketed schemes. They are only one part of a broader program of increased vigilance by the ATO and much tighter regulation of the financial services industry by ASIC under the *Corporations Act*.<sup>44</sup>

Whilst product rulings have been very influential, they are not without their limitations. They are not intended to provide any guarantee to taxpayers on the commercial viability of a product. Unfortunately, a high proportion of mass marketed investment schemes have been highly speculative from a commercial perspective. Another particular concern is that recent data on the environmental outcomes of some of the more popular agribusiness investment schemes suggest that there are severe environmental cost imposed upon the general community by some of the most successful investment products; in particular, plantation forestry ventures.

## **AGRIBUSINESS and ECOLOGICAL SUSTAINABILITY**

A major consequence of the concerted attack on MMIS by the ATO and ASIC is that there has been a severe shake-out of schemes which were not able to clearly establish eligibility for taxation concessions and full compliance with *Corporations Act* obligations. As a consequence, it has been estimated that investment in

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<sup>44</sup> See *Corporations Act* Chapter 5C (introduced from 1 July 1998 by the *Managed Investments Act 1998*), administered by the Australian Securities and Investment Commission ('ASIC').

agribusiness has declined by a massive 75% over four years, from 1.2 billion in 1998-99 to 300 million in 2002-03.<sup>45</sup> It is now widely recognised in the agribusiness industry that an ATO product ruling is almost essential for a scheme to be marketable.<sup>46</sup> The market is now dominated by a relatively narrow range of products and promoters, as indicated by the following data on product rulings issued for the years ending 30 June 2003 and the current 2004 tax year:

**Table 1: ATO Product Rulings for 2002-3 and 2003-4 tax years**

| Type of product     | 2002-2003 | 2003-2004* |
|---------------------|-----------|------------|
| Plantation forestry | 40        | 14         |
| Vineyards           | 11        | 4          |
| Olives              | 10        | 2          |
| Exotic fruits       | 2         | 3          |
| Financial products  | 15        | 6          |
| Films               | 4         | 2          |
| <b>Total</b>        | <b>82</b> | <b>31</b>  |

\* as at March 2004

It is noticeable that the most successful agribusiness schemes at present are plantation forestry and vineyards which together account for about 60 % of all product rulings. Two prominent examples of successful forestry schemes that have recent product rulings are Great Southern Plantations, which operates in south western Victoria (PR 2004/5), and Gunns Plantation Woodlot, which operates in Tasmania (PR 2003/21). The funds raised from these products are to be used for new forestry ventures in two regions where there is considerable community unrest about the environmental impacts of plantation forestry. For instance the Australian Conservation Foundation recently described the ecological impact of plantation forestry in Tasmania as follows:

‘An average of 20,000 hectares of native forest are clearfelled and burnt each year in Tasmania. Around two thirds of this land is replanted with plantations - regimented rows of exotic trees destined for cutting down again after 15-25 years. The native forest and the native wildlife are lost forever. As part of the replanting, the poison 1080 is often laid to stop

45 Agribusiness Research (2002) reported by Mark Fenton Jones (2002) ‘Tax Schemes Show Signs of Life Again’ press article in *Australian Financial Review* 23 July 2002 at p 51.

46 SERC para 1.44.

wildlife disturbing the seedlings – this poison kills thousands of wallabies, betongs, wombats and possums every year.

Over 90% of the timber extracted is woodchipped and Tasmania exports more woodchips than all other states of Australia put together. The forest being destroyed is ancient, beautiful, irreplaceable and important to biodiversity. Tasmania has the tallest hardwood forests on Earth, with trees reaching over 90 metres. Tasmania has Australia's greatest tract of temperate rainforest – in the little-known Tarkine wilderness in the north-west of the state. Northern and Eastern Tasmania contain significant tracts of dry-sclerophyll eucalypt forest.

While pressure from the Australian public has helped to protect some of the high-conservation value old-growth forest, more than 200,000 hectares still face destruction. Logging is advancing at a frightening rate.'

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Another serious consequence of new forestry plantations is a major change to surface water regimes, whereby new plantations in the upper regions of a catchment will seriously deplete in-stream water flows to the lower catchment (where traditionally most water extraction has taken place).<sup>48</sup> Whilst it is not appropriate to canvas the full range of evidence for and against plantation forestry in this paper, there is little doubt that plantation forestry has many adverse environmental outcomes. Similar ecological concerns can also be raised in relation to other successful agribusiness ventures like vineyards and intensive horticulture projects. The most recent Australian 'State of the Environment' Report prepared by the Federal government in 2001, concludes that 'degradation of lands and waters remains of critical concern' and 'the clearing of mature forests ... for economic reasons continues to raise many environmental concerns about the consequences of such actions on river water quality, soil quality and ecosystem loss in catchments and in areas far removed from the land clearing activities'.<sup>49</sup>

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47 Australian Conservation Foundation (2004) 'New Initiative to Protect Tasmania's Precious Forests', at: <http://www.acfonline.org.au/asp/pages/document.asp?IdDoc=1827> (accessed 22 March 2004).

48 Melissa Fyfe (2003) 'Land study queries tree plantations' *The Age*, January 15 2003 – reporting on recent studies by the Cooperative Research Centre for Catchment Hydrology.

49 Environment Australia (2001) *Australia State of the Environment 2001*, Executive Overview pp 3-4.



One of the drivers of plantation forestry projects has been the Federal Government's policy statement *Plantations for Australia; the 2020 Vision*, which established an objective of trebling the area of commercial tree crops by 2020 in order to enhance regional wealth creation and international competitiveness through a sustainable increase in Australia's plantation resources.<sup>50</sup> A recent Senate Inquiry into Plantation Forestry has revealed many environmental concerns relating to this industry and recommended that the 2020 Vision be amended by deleting all references to trebling the acreage by 2020. In place of this target the Senate Inquiry recommended a target of increasing the acreage of plantation forests at a 'sustainable and economic level'.<sup>51</sup> It is not suggested that all plantation forestry ventures are harmful to the environment. However there is cause for concern when it is noted that plantation forestry is the most successful category of agribusiness investment products currently on the market, and much of the attraction is due to the availability of a wide range of taxation concessions that apply to primary production activities. It is contended by the author that the recognized environmental dangers associated with plantation forestry require that a mechanism for assessing the ecological sustainability of ventures seeking taxation concessions must be established.

Such a mechanism would serve at least two important two functions. Firstly it would provide investors with some greater assurance that their funds were being applied to an ecologically sustainable enterprise.<sup>52</sup> Secondly it would assist the Australian government in meeting its obligations on conservation of biodiversity, climate change and sustainable development under various international treaties.

#### **A proposed mechanism to promote more sustainable agribusiness ventures**

ATO product rulings now play a key role in providing comfort to investors that the taxation promises made in investment prospectuses are validly based. It is recommended here that this model should be extended to include a suitable environmental impact assessment of agribusiness investment proposals should be carried out before a product ruling on taxation matters can be issued. Of course,

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50 Department of Forestry, Fisheries and Aquaculture (1997) *Plantations for Australia; the 2020 Vision*

51 Senate Rural and Regional Affairs and Transport References Committee Inquiry into Planatation Forestry

52 The integration of sustainability into investment evaluation is a key point recognized by the recent *Mays Report* in to corporate sustainability. See Dept of Environment and Heritage (2003) 'Corporate Sustainability; The Investor Perspective (The Mays Report)' – available at [www.deh.gov.au](http://www.deh.gov.au).

the Commissioner of Taxation's power to make rulings is clearly limited to the application of taxation laws. However, it is not unusual for taxation concessions to be conditional upon a taxpayer meeting 'non-tax' criteria, as is the case for 'complying superannuation funds', which must be issued a notice by the Australian Prudential Regulatory Agency ('APRA') to establish that the fund has met various prudential regulations.<sup>53</sup> Thus it would not be unusual to introduce a similar 'precondition' that an agribusiness venture must be certified as ecologically sustainable by an appropriate accreditation agency, before it was entitled to claim taxation concessions.

One argument against this proposition is that environmental impact assessments are already provided for under other legislation. However, it is submitted here that a review of the current framework for the environmental assessment of agribusiness ventures reveals that this is not the case. Australia was an early mover on 'environmental impact assessment' ('EIA') by world standards, when the Whitlam government introduced the *Environment Protection (Impact of Proposals) Act* (Cwth) in 1974.<sup>54</sup> Since then the various Australian State governments have also introduced their own similar EIA procedures which often overlap the Federal government system.<sup>55</sup> However the State provisions are not rigorous, as they are triggered principally at the discretion of a relevant Minister, and there was a lack of redress to the courts for parties affected by the proposal. Thus the EIA process is only effective when it was backed by sufficient political will, which the Whitlam government clearly had in the early 1970s, but this has not been maintained by subsequent governments.<sup>56</sup> And it has rarely, perhaps never, been applied to individual agricultural or forestry ventures.

Another fear may be that this proposal for greater Federal intervention in land use decisions will re-ignite the constitutional battles of the 1980s when State governments strongly resisted Federal intervention in their traditional role as managers of the natural resources. At that time, a series of High Court challenges were made by various States against Federal laws aimed at protecting the

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53 As specified in the *Superannuation Industry (Supervision) Act* 1993 (Cwth).

54 The Australian government followed similar legislation in the United States; the *National Environmental Policy Act* 1970 (USA), introduced by the Nixon administration in 1970, required all federal agencies to (inter alia) include a detailed report on environmental impact in all proposals for new legislation or other Federal action.

55 Eg. see the *Environment Effects Act* 1978 (Vic).

56 One of the first matters assessed under the EPIP Act was proposals for uranium mining in Kakadu National Park.

environmental attributes of World Heritage sites like Fraser Island, the Daintree rainforests, the Franklin River and south-west Tasmanian forests.<sup>57</sup> The Federal government was concerned that these sites were threatened by State-approved activities like mining, hydro-electric dams and forestry. Whilst the Federal government won these legal battles, it ultimately accepted a broader political compromise that conceded practical management of many environmental matters to the States.<sup>58</sup> The terms of this compromise are now embodied in the *Environment Protection and Biodiversity Conservation Act 1999* (Cwth) (the 'EPBC Act'), which includes a comprehensive framework for EIA by the Federal government. However these Federal EIA procedures are only 'triggered' if the proposal has a significant impact on a matter of 'national environmental significance'. There are now seven matters specified as EIA triggers under the EPBC Act:

World heritage sites

- National heritage places (from 1 January 2004)
- Ramsar wetlands
- Threatened species and ecosystems
- Listed migratory species
- Nuclear activities
- Commonwealth marine areas.<sup>59</sup>

Thus the Federal EIA procedures are not universal, being limited to these seven specific matters. It should also be noted that these specific matters do not directly cover some of the most pressing environmental problems associated with agribusiness and forestry ventures in Australia, such as deforestation, loss of biodiversity, overuse of water and salinity. The intention of the EPBC Act approach is that these matters should be dealt with by the State governments under their own land use planning or EIA procedures but it is apparent from the continuing deterioration in sustainability indicators relating to land use that the States unwilling or incapable of fulfilling this responsibility.

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57 For an detailed account, see Ben Boer (1992) 7 *Journal of Environmental Law and Litigation* 247.

58 See the *Intergovernmental Agreement on the Environment* 1992, incorporated in the appendix to *National Environment Protection Council Act* 1994.

59 See *EPBC Act* ss 12-23. There are also some general triggers such as actions on Commonwealth land and actions by a Commonwealth agency (ss 26 and 28).

Under State government land use and planning laws the usual regulatory framework requires all new developments to comply with State and local government planning provisions, which generally establish a series of land use 'zones'. Each designated zone has a range of permitted land uses, with some uses permitted as of right, whilst others are specifically prohibited, or permitted only with approval of the local authority.<sup>60</sup> It is alarming to note that in a typical 'Rural Zone' there may be no distinction made between various forms of agriculture ranging from grazing, cropping intensive horticulture and orchards, to forestry and plantations, and any of these are often permitted without the need for a permit.<sup>61</sup> Thus the question whether a specific agricultural venture or forestry plantation is environmentally sustainable would never even be asked at the planning approval stage. And farmers who decide to switch from cropping or grazing to tree plantations may not need a planning permit, or may obtain one with minimal conditions. Of course there is a powerful political reality at work here, as local government officials do not wish to inhibit new developments, as the view is often held that any investment in declining regional communities is 'good' investment. There is also a fundamental limitation that State planning laws they do not generally apply to crown lands, and accordingly the establishment of new plantations on crown land is largely at the discretion of the State. Many recent forestry investment schemes are actually located on crown land that has been made available to promoters.

This discussion is not intended to provide a comprehensive account of regional land use laws and there will be a range of other legislation that may apply restrictions on agribusiness ventures, such as restrictions on clearing of native vegetation. However the point to be emphasized is that many ecologically harmful agribusiness activities are rarely subjected to formal EIA processes. The formal EIA rules are only likely to be applied to large scale and relatively unusual development activities, for instance, novel developments that may introduce a substantial new element into the existing natural environment. In this context agribusiness ventures tend to be 'under the radar', as their individual impacts would not be considered significant and they are generally permitted by local planning laws. Larger agribusiness projects involving 'conventional' activities like forestry plantations or irrigation ventures would also be overlooked as they would be viewed as a continuing use in a rural zone. This blinkered view of the environmental effects of agribusiness ventures was exemplified in the recent *Nathan Dam* case where the Federal Minister for Environment and Heritage himself decided that no assessment was necessary under the EPBC Act for a major

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60 See eg. *Planning and Environment Act 1987* (Vic).

61 See *Victorian Planning Provisions*, Clause 35.01.

irrigation dam on a tributary of the Fitzroy River in central Queensland (this decision that has now been set aside by the Federal Court who found that there not been adequate investigation of the impact of this project upon the World Heritage values of the Great Barrier Reef).<sup>62</sup> The Full Federal Court has now rejected an appeal by the Minister against this decision.<sup>63</sup>

Even where a formal EIA process is applied, it may suffer from many procedural weaknesses including, *inter alia*, that the EIA documentation is usually prepared by the proponent of a venture, it comes too late in the decision making process and it does not give sufficient weight to public comment.<sup>64</sup> A further inherent weakness is that, even where an assessment is required, the EIA process does not determine the outcome of a development proposal. EIA merely informs the decision maker, who is then obliged to take the EIA findings into account, in accordance with administrative law. Thus political objectives are very capable of overriding ecological objectives when the ultimate decision is made. A recent example of this is scenario is the Meander Dam proposal in northern Tasmania, which was initially rejected by the *Resource Management and Appeals Tribunal* in that State. This decision was based on evidence of the likely impact of the dam on certain endangered species and an economic analysis that indicated the benefit of the dam would be less than zero. The Tasmanian government subsequently legislated to specifically overrule this decision and a Federal EPBC Act assessment has now approved the project.<sup>65</sup>

It can be concluded from this review of EIA processes that there is currently a lack of effective environmental assessment procedure for new agribusiness ventures, and that this is a serious concern given the current chronic problems of land degradation and water scarcity in Australia identified in the *Australian State of the Environment* Report. Accordingly a more comprehensive, robust EIA mechanism is urgently required in this sector.

It is also submitted that the Federal taxation system is highly appropriate vehicle for administration of this task. It is highly relevant to note that the taxation system

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62 *Queensland Conservation Council & ors v Minister for Env'tment & Heritage* (2003) FCA 1463 (19 Dec 2003).

63 *Minister for Env'tment & Heritage v Queensland Conservation Council* (2004) FCAFC 190 (30 July 2004).

64 Gerry Bates (2002) *Environmental Law in Australia* (5<sup>th</sup> edition, LexisNexis Butterworths) 325-333.

65 The Hon David Kemp (2003) Transcript of press conference at Launceston, 19 Sept 2003 – available at [www.deh.gov.au/minister/env/2003](http://www.deh.gov.au/minister/env/2003) (accessed 23/3/04).

provides a substantial subsidy for agribusiness schemes. Whilst the full extent of this public subsidy is difficult to ascertain, an indication of its magnitude is given by the inquiries into mass marketed schemes which revealed that deductions of over \$1 billion per annum that were being claimed by investors in mass marketed schemes during the late 1990s.<sup>66</sup> And this is only the tip of the iceberg, as similar taxation concessions are provided to a multitude of 'privately funded' agribusiness developments which do not seek investment funds through mass-marketed schemes, and these ventures would similarly contribute to the environmental problems mentioned above. Thus it is argued here that the proposition should be extended beyond MMIS, to require that *any* new primary production or forestry venture seeking taxation concessions should demonstrate that its activities are ecologically sustainable, before being eligible for tax relief.

One advantage of using environmental sustainability as a precondition for taxation concessions is that the Federal government will avoid interfering in any traditional State land use planning roles, but will merely exercise the right to withdraw Federal taxation concessions based on environmental criteria. Thus in constitutional terms, it will be making a law 'with respect to taxation' within the meaning of placita 51(ii). The use of Federal powers in this manner can be well justified to give better control over multi-jurisdictional land use problems like land degradation in the Murray-Darling Basin. It could be a logical and highly efficient strategy to meet Australia's obligations under a range of international agreements on matters such as World Heritage, climate change and conservation of biodiversity.

This proposal is supported by the accepted principles of 'ecological tax reform', as well as the traditional taxation policy objectives of efficiency and equity. Efficiency demands that investment choices should be neutral, and it should provide that investors in agribusiness ventures are not attracted by 'perverse' subsidies which give an advantage to environmentally harmful activities over more socially responsible alternatives. In particular, agribusiness investment schemes that are only commercially attractive due to tax breaks, whilst producing 'external costs' borne by other parties and future generations, can be discouraged by the removal of tax concessions. On the other hand, agribusiness ventures that are ecologically sustainable will continue to get the full measure of taxation concessions.

One practical issue is that this proposal requires an approval process for accreditation of enterprises that can demonstrate that their activities are

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66 SERC (2002) at para 1.17, Table 1. as evidenced by the ATO disallowing \$1.5 billion in deductions in 1998-99 alone

ecologically sustainable. This would go beyond the scope of the current EIA processes, which are only designed to elicit relevant information for consideration by the relevant decision maker. The new environmental approval process might be administered by a new Federal agency which could draw upon the existing experience and skills that exist in various government agencies such as the environmental assessment division of the Federal Department of Environment and Heritage, the product ruling group of ATO and the financial services division of ASIC. There would also be scope for outsourcing this process through the use of accredited environmental auditors, which is a system already used in other areas of environmental compliance.<sup>67</sup> There would be considerable cost involved in establishing the new agency and implementing its functions across the whole of Australia, however this would be easily recouped in additional tax revenue gained from the removal of tax concessions from unsustainable enterprises and the avoidance of some of the expected massive future cost of remediation of land degradation.<sup>68</sup> It would also be appropriate to impose a user pays system upon the proponents of new agribusiness ventures, to cover to the cost of the new environmental approval process.

### Concluding Summary

In summary, the foregoing consideration of the agribusiness sector reveals that the product ruling system and financial services reform have provided investors with a great deal more certainty about the financial and taxation consequences of agribusiness ventures in rural Australia. However it is apparent that there is a significant failure of environmental assessment processes in regional Australia, with the result that a range of serious land degradation problems are not improving, but seem to be getting worse. This outcome is not surprising, given the powerful influence of short term political objectives at the State and local government level which favors exploitation of natural resources to the detriment of the natural environment. This paper proposes that the Federal taxation system can be used as a very effective alternative mechanism to deal with this problem, in a

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67 For instance, the Federal Minister may require an environmental auditor to be appointed to carry out various functions under s 459 of the *Environment Protection and Biodiversity Conservation Act 1999* (Cwth) and see also s 53S *Environment Protection Act 1970* (Vic) under which the Victorian EPA may appoint an environmental auditor to carry out certain statutory requirements.

68 It has been estimated that land and water degradation excluding weeds and pests currently costs Australia \$3.5 billion per year; see Media Release by Prime Minister John Howard (2000) *Council of Australian Governments Communique*, 3 November 2000.

way that will not offend traditional legislative responsibilities of the State governments. The proposal recognizes that agribusiness and other primary production activities are heavily subsidised by the Federal government through a vast range of taxation deductions and other tax concessions. It also recognizes that the Federal government has a responsibility to ensure that regional Australia develops in an ecologically sustainable manner. Accordingly, it is proposed that a new Federal agency be created to assess the ecological sustainability of all new primary production enterprises. Under this proposal, only duly accredited 'complying' rural enterprises would be entitled to claim Federal taxation concessions.