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Mr Tom Reid
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600
By email taxlawdesign@treasury.gov.au

Dear Mr Reid

# Changes to the Farm Managed Deposit Scheme

The Australian Bankers' Association **(ABA)** welcomes the opportunity to provide comments on the Exposure Draft Tax Laws Amendment (Farm management deposit reform) Bill 2016.

Farm management deposits **(FMD)** are a successful risk management tool that assist farmers to manage the volatility of farm incomes. The ABA supports doubling the deposit limit from $400,000 to $800,000 to assist farmers setting aside increased reserves for risk management purposes and supports the change to early access provisions for farmers during severe drought.

The provision of FMD offset arrangements will be a commercial decision for individual banks. Australian banks provide various banking products and services to agribusiness customers including: accounts to make money management easier, loans and finance solutions for new equipment, property and business expansion, investment options to smooth cash flows, interest bearing accounts and risk management and advice to manage business risks and prepare for the future. Individual banks will need to assess the suitability and complexity of providing an offset product within the suite of products they already provide. It should be noted that the introduction of an FMD offset arrangement may be technically complex and expensive for some banks to implement.

The exposure draft in its current form does not provide sufficient guidance to industry on the offset arrangement. Our understanding is the offset arrangements will only be applicable to individuals and partnerships with accounts and loans in the same name. Treasury and the Australian Taxation Office (ATO) will however need to provide further guidance to industry on operational aspects of the offset facility to ensure that a consistent approach is adopted by Authorised Deposit-Taking Institutions (ADIs). This will lead to greater clarity for customers in making comparisons between product offerings. A list of the technical and implementation issues that require clarification is attached (Attachment 1).

We also note that the provision of offset arrangements will encourage farmers to place an FMD with the institution where they hold their loan. This will reduce the effectiveness of the 2012 changes that were designed to encourage competition in the FMD market by allowing customers to hold an FMD across multiple financial institutions.

## Transition arrangements and implementation timeframes

The ABA is concerned that the Government has not allowed sufficient time for industry to appropriately assess and develop offset products and implement regulatory change. The development of a new bank product requires a significant investment of time and resources in product design, compliance, amendments to credit policies and changes to core bank information and technology systems.

The exposure draft does not provide a realistic transition period, given compliance is expected for the 2016-2017 income tax year. Banks will likely require an approximate six month transition period (from the date of Royal Assent) to implement the changes to double the deposit limit and apply the early withdrawal provisions.

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Banks will require a longer transition to implement the offset facility proposal (potentially 12 months depending on the complexity of the systems change required). The final design of an FMD offset product would not occur until all changes to the legislation and associated regulations are finalised. Treasury has indicated that the changes to the FMD legislation will not be introduced until the autumn 2016 session of Parliament, with subsequent amendments to associated tax regulations. Given this timeframe, it is highly unlikely that banks will be in a position to provide FMD offset products from 1 July 2016.

## Red tape and potential costs for farmers

While the ABA supports the Government's policy objective of providing a mechanism to reduce financial pressures for farmers, we are concerned this may unintentionally result in increased red tape and management costs, for example, changing farm ownership structures to take advantage of the offset arrangements may attract further legal and administrative costs. The FMD offset changes may also restrict how farmers structure their debt and could limit the take up of alternative farm ownership arrangements.

## Potential capital requirements

The ABA is concerned that the provision of FMD loan offsets has the potential to impact bank capital and liquidity requirements, as loan offset accounts are generally at-call and not term deposits. Treasury has indicated that although APRA has advised no prudential regulatory changes are required, banks may wish to seek legal advice as to capital requirements (depending on the specific loan offset arrangements and products that may be developed). This may have cost implications for banks and impact the price of lending.

If you have any questions please contact Amanda Pullinger, Policy Consultant – Retail Policy on (02) 8298 0411 or by email: apullinger@bankers.asn.au.

Yours sincerely

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# Attachment 1 - Technical issues and questions requiring clarification

## Definitions

- Definition of ‘loans or other debts’ in the proposed changes – currently the only qualifier is that the ‘loan or other debt’ is used for ‘carrying on of a primary production business’, but it is not clear whether there are any restrictions on the type of loan (business loan, asset finance, whether applicable to on- or off-balance sheet debts).
- Definition of ‘partnership’ and how the ‘partners’ will be identified. Must the partnership only comprise ‘Individual’ partners? A large portion of farming enterprises are set up as trusts or companies, so in order to take advantage of the offset provisions, they could be required to change legal entities, which may attract further set-up costs.

## Operation of FMD offset arrangements

- Would the FMD be able to be part broken during its 12 months? This will occur as the client is not always in a position to know if the full amount in the account is to be treated as a FMD or not (primary producer may not have claimed tax deductions for the full amount for a number of reasons). This could have significant tax consequences for the primary producer, affecting the use of the FMD as an offset account and its viability for the primary producer.
- The current law requires that a new FMD account needs to be established upon the combination of FMD accounts. Further, the current law requires that the customer must have held the FMD account for 12 months before combining accounts. If an existing FMD cannot operate as an offset account and a new FMD account is required to be opened or two FMD accounts need to be combined into one FMD offset account, does the 12 month qualification requirement continue to apply?
- Will there be additional reporting requirements for banks due to the changes?

## Severe drought arrangements

- The new law provides that an amount withdrawn within the first 12 months from an FMD will not lose its taxation treatment if prescribed rainfall conditions are met. The exposure draft does not provide details of who will be responsible for ensuring that the business has satisfied the rainfall deficiency criteria. Will the onus be on the ADI to verify whether the customer has met the criteria prior to withdrawal? If so, how will this be managed? Or will the customer be required to provide a declaration/acknowledgement that it has met the rainfall conditions? Will the ATO be monitoring compliance with the criteria?

## Administrative penalty

- The offset arrangement will allow the owner of the FMD to reduce interest charges on “qualifying loan offset arrangements”. An administrative penalty will be imposed if an FMD is applied for “non-qualifying loan purposes, including non-primary production business or private loans”. The penalty will be equal to 200 per cent of the amount by which interest has been reduced on the portion of the loan used for the non-qualifying purposes. The exposure draft does not provide details of who will be responsible for calculating and enforcing the administrative penalty. Will the onus be on the financial institution to monitor any interest reduction on non-qualifying loans? If so, how will this be managed?