National Farmers' Federation

Submission to Treasury inquiry into Agricultural Competitiveness White Paper changes to Farm Management Deposits

December 2015

NFF Member Organisations

The National Farmers' Federation (NFF) was established in 1979 and is the peak national body representing farmers, and more broadly, agriculture across Australia. The NFF's membership comprises all of Australia's major agricultural commodities.

Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

Following a restructure of the organisation in 2009, a broader cross section of the agricultural sector has been enabled to become members of the NFF, including the breadth and the length of the supply chain.

While our members address state-based 'grass roots' or commodity specific issues, the NFF's focus is representing the interests of agriculture and progressing our national and international priorities.

The NFF has for 36 years consistently engaged in policy interaction with government regarding a range of issues of importance to the sector including trade, education, environment, innovation to name a few.

The NFF is committed to advancing Australian agriculture by developing and advocating for policies that support the profitability and productivity of Australian farmers.

Statistics on Australian Agriculture

Australian agriculture makes an important contribution to Australia's social, economic and environmental sustainability.

Social >

There are approximately 115,000 farm businesses in Australia, 99 percent of which are family owned and operated.

Each Australian farmer produces enough food each year to feed 600 people, 150 at home and 450 overseas. Australian farms produce around 93 percent of the total volume of food consumed in Australia.

Economic >

The agricultural sector, at farm-gate, contributes 2.4 percent to Australia's total Gross Domestic Product (GDP). The gross value of Australian farm production in 2013-14 was $51 billion – a 6 percent increase from the previous financial year.

Yet this is only part of the picture. When the vital value-adding processes that food and fibre go through once they leave the farm are added in, along with the value of all economic activities supporting farm production through farm inputs, agriculture's contribution to GDP averages out at around 12 percent (over $155 billion).

Environmental >

Australian farmers are environmental stewards, owning, managing and caring for
52 percent of Australia's land mass.

Farmers are at the frontline of delivering environmental outcomes on behalf of the Australian community, with 94 percent of Australian farmers actively undertaking natural resource management.

The NFF was a founding partner of the Landcare movement, which in 2014, celebrated its 25th anniversary.

Contents

Introduction

The National Farmers' Federation (NFF) welcomes the opportunity to provide comment on the proposed changes to the Farm Management Deposit Scheme. The NFF views the Farm Managed Deposit Scheme (FMD) as a valuable financial risk management tool for farmers to help smooth the uneven income streams that are common in agriculture due to climate and market variability. FMDs can assist individual farmers to build their self-reliance and improve resilience to future disruptions to production.

The submission is structured into four sections:

1. **Summary of recommendations;** a summary of the NFF's recommendations with regards to the proposed changes, as well as broader issues concerning FMDs.
2. **Background;** the policy rationale behind the FMD scheme as well as the outcomes of recent reviews.
3. **Response to proposed changes;** the NFF's position on the proposed changes recommended in the Agricultural Competitiveness White Paper.
4. **Other Recommendations;** other recommendations regarding the structure and operation of the FMD scheme.

Should you seek any further information regarding this review, please do not hesitate to contact Mr Tony Mahar, Deputy Chief Executive at tmahar@nff.org.au or on 02 6269 5666.

Summary of Recommendations

1. The NFF supports doubling the cap on deposits from $400,000 to $800,000.

2. The NFF supports the re-establishment of an early access trigger during times of drought.

3. The NFF supports allowing FMDs to be used to offset the interest on primary production debt, dependent upon financial institutions putting these facilities in place in a way that won’t create a significant administrative burden for producers.

4. The NFF supports FMDs being made available at the entity level as well as at the individual level.

5. Government consideration should be given to how FMD withdrawals impact on the non-commercial loss rules under Division 35 of ITAA1997, ensuring no negative impact occurs on the part of primary producers.

6. Government should consider undertaking targeted awareness campaigns for farmers focusing on groups such as accountants servicing rural clients.

Background

<u>The policy rationale behind Farm Management Deposits</u>

FMDs are a financial risk management tool for farmers to help smooth the uneven income streams that are common in agriculture due to climate and market variability. The NFF views FMDs as a key risk management tool for individual farmers to build their self-reliance with regards to market volatility, future droughts and longer-term climate variability.

The FMD scheme encourages individual primary producers to increase financial self-reliance by setting aside pre-tax income in good years for use in low-income years. The FMD scheme began on 2 January 1999, replacing the Australian Government's Income Equalisation Deposit and Farm Management Bond schemes. Since its inception, the FMD scheme has played a key role in drought preparedness and in-event management.

FMDs provide tax benefits if kept for at least 12 months, as tax is not payable on the income until the financial year it is withdrawn, when primary producers may benefit from a lower marginal tax rate. Under the previous Exceptional Circumstances (EC) arrangements, eligible primary producers in EC declared areas could access their FMDs within 12 months while retaining the tax benefits of the scheme. A similar provision is also in place for eligible primary producers within a region declared under the National Disaster Relief and Recovery Arrangements (NDRRA).

<u>Reviews of Farm Management Deposits</u>

There have been a number of reviews into FMDs, which have reinforced its value as a risk and tax management tool. In 2006, the Australian Government Department of Agriculture, Fisheries and Forestry (DAFF) undertook an all-encompassing review of the scheme[1]. The review found that FMDs were meeting thier objectives as a tax-linked, financial risk management tool for primary producers. The review stated that ‘Without FMDs, poorly timed expenditure may be forced on farmers as they hurriedly seek to obtain off-setting tax deductions before the end of a high-income financial year. Poorly timed expenditure leads to sub-optimal productivity and leaves farmers more financially vulnerable than they need be.’

In 2011, the National Rural Advisory Council conducted a further review in to the scheme. Along with assessing the ability of the scheme to meet its policy objectives, the review also had a particular focus on the ability of FMDs to support farmers in managing risk associated with climate variability and market volatility. With regards to managing such agricultural risk, the review concluded that ‘there is no doubt that the scheme is an important tool for farmers across Australia’[2].

[1] 2006 Review of the Farm Management Deposits Scheme November 2006 (2007). Department of Agriculture, Fisheries and Forestry. Australian Government.
[2] National Rural Advisory Council (2012), Report on the effectiveness of the Farm Management Deposits Scheme, Department of Agriculture, Fisheries and Forestry.

Response to proposed changes

Increasing deposit threshold

The NFF supports doubling the cap on deposits from $400,000 to $800,000. An update of the deposit cap reflects the changes required to operate a modern farming business and allows farmers to better manage future risk. To ensure that FMD's remain relevant and a useful tool for farmers to manage variable income, it is recommended that regular reviews (3-5years) of the deposit cap, and other thresholds such as the off-farm income threshold occur. Regular updates would allow for FMD criteria to maintain pace with inflation (potentially using agricultural inputs as a basis) and changes in farm businesses.

Early access trigger

The NFF supports the re-establishment of an early access trigger during times of drought. However, the proposal is to use the 0-5th decile rainfall charts for the last six months as a measure of drought conditions may be problematic. See appendix 1 for the difference between the current 6 month and 9 month maps due to the impact of the failed wet season on the North. The six month period in isolation may not be sufficient, particularly depending when deposits were made, and the critical timing for rainfall across different parts of the country.

Offsetting interest on primary production debt

The NFF supports allowing FMDs to be used to offset the interest on primary production debt. However, it will be dependent upon financial institutions putting these facilities in place in a way that won't create a significant administrative burden for producers (e.g. complicated new loan documentation and/or additional cost).

However, the NFF holds some concerns about the practicalities associated with interest on FMDs held by individuals. These include FMD's being available to offset interest expenses on a loan held for the primary production business operated by a different trading entity (e.g. partnership or trust).

Typically loans are held in the name of the business, not individual partners of a partnership or beneficiaries of a trust. See comments below about consideration of FMD's being in the name of business entities, in addition to individuals. Determining whether a loan is wholly related to the primary production business may add additional administrative burden. This need to be considered by policy makers

Other Recommendations

In addition to the comments pertaining to the proposed changes outlined in the Agricultural Competitiveness White Paper, the NFF has taken this opportunity to make the following additional recommendations regarding the structure and operation of the FMD scheme.

<u>Expansion of FMD's to the entity level in addition to individual level</u>

FMDs should be available at the entity level as well as at the individual level. For example, money invested in a FMD in the name of a partnership would be deducted from the assessable income of the partnership before profit is distributed to partners. Assessable income withdrawn from an FMD would then be added to the partnership income before profit is distributed to partners. As part of this proposal, eligibility could be extended to Companies and Trusts. Some integrity measures may be required to prevent manipulation of entity structures that may artificially increase the effective maximum deposit limit.

FMD measures allow cash generated in a good season to be set aside to ensure cash is available to fund operations in less favourable times.

The way the system currently works for a partnership means that an individual partner must draw money (or take a loan) from the partnership to invest in an FMD. Following this, there must be an agreement (partnership agreement and/or loan documentation) for that money to be paid back to the partnership upon its withdrawal if the funds are going to be available to the business entity for their intended purpose (ie to fund the businesses in leaner years).

This same problem occurs for beneficiaries of trusts. Most related party businesses don't have this degree of governance in place and therefore rely upon partners and beneficiaries 'doing the right thing'.

Companies operating in the sector have the same variability in income as an individual operating the same business. While a flat tax rate avoids the problems of paying tax at higher marginal rates during more profitable years, the cash flow impacts (including higher PAYG instalments) associated with income volatility are of the same significance as any other entity. It seems inequitable that FMD's are not available to this type of structure. To counteract the benefit of the flat tax rate, companies could be limited in the length that they can hold deposits, and potentially limited to a different threshold to that of individuals.

A further consideration may be to allow FMDs that remain on deposit upon retirement or cessation of the relevant primary production business to be contributed to superannuation under a separate form of concessional contribution cap. Due to the variability of cash flow and the capital intensive nature of agriculture, business assets frequently form a significant part of a primary producers retirement planning. To ensure that no unintended advantage is provided, integrity measures could be introduced. For instance the FMD contribution cap may be limited to the sum of the individuals previous 10 years of personal concessional contribution caps, less the amounts of concessional contributions actually made during that period.

If significant changes are made to the eligibility for individuals and corporations to utilise the FMD provisions, it would be important to ensure that existing deposits are grandfathered and transitional provisions implemented.

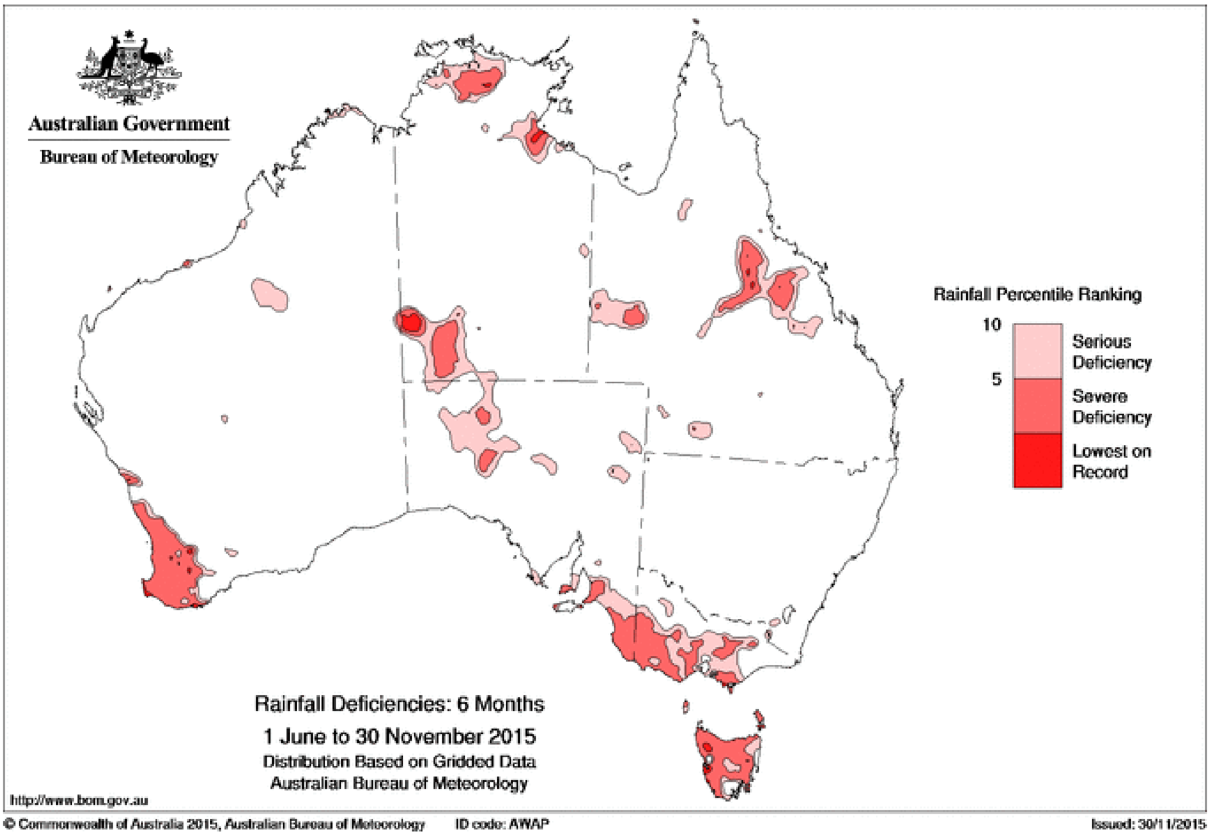
Impact on non-commercial loss rules

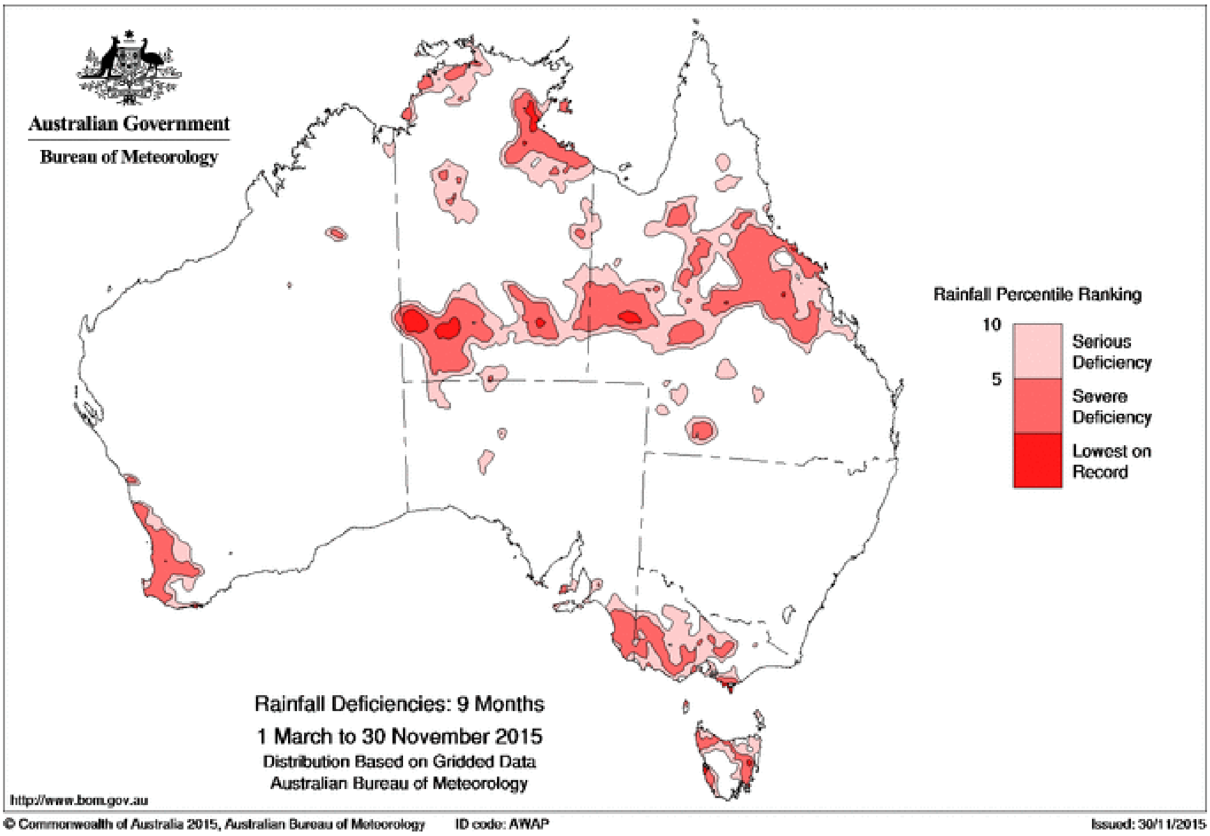
In the context of the current system, The NFF also holds concerns regarding FMD withdrawals and how they impact the non-commercial loss rules under Division 35 of ITAA1997. Currently the Australian Taxation Office have taken the position that where a FMD is withdrawn, it is not considered income from the business activity unless the money is reinvested back in the business. Even though the income may have been generated by the same business as when the FMD is withdrawn in a loss year, unless the cash associated with the FMD is reinvested back into the business, the FMD withdrawn will itself count towards the $250,000 other income cap. If this income cap, including the FMD withdrawal, exceeds $250,000 it would result in the FMD withdrawn amount being taxable and any business loss being quarantined.

The need for targeted awareness of FMD scheme

The NFF recognises that compared to other similar schemes, FMD's have a relatively high awareness rate among the farming community. Notwithstanding this, targeted campaigns could be undertaken to ensure the highest level of awareness of FMDs and any amendments to them. Through consultation with industry partners, the NFF recommends that accountantss with primary producer clients, or appropriate accounting industry organisations, be supported to inform farmers of the existence and benefits of FMDs. With accountancy firms often the primary source of taxation and financial risk management tools for farmers, this will serve as an appropriate communication channel. Such efforts will complement the work farm industry bodies already undertake in this regard.

Appendix 1


Australian Government
Bureau of Meteorology
Rainfall Percentile Ranking
10
5
Serious Deficiency
Severe Deficiency
Lowest on Record
Rainfall Deficiencies: 6 Months
1 June to 30 November 2015
Distribution Based on Gridded Data
Australian Bureau of Meteorology
http://www.bom.gov.au
© Commonwealth of Australia 2015, Australian Bureau of Meteorology
ID code: AWAP
Issued: 30/11/2015


Australian Government
Bureau of Meteorology
Rainfall Percentile Ranking
10
5
Serious Deficiency
Severe Deficiency
Lowest on Record
Rainfall Deficiencies: 9 Months
1 March to 30 November 2015
Distribution Based on Gridded Data
Australian Bureau of Meteorology
http://www.bom.gov.au
© Commonwealth of Australia 2015, Australian Bureau of Meteorology
ID code: AWAP
Issued: 30/11/2015