CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia
GPO Box 2820 Melbourne
VIC 3001 Australia
T 1300 737 373
Outside Aust +613 9606 9677
cpaaustralia.com.au

26 April 2021

FMDS Evaluation Secretariat
Farm Management Deposits Scheme
Department of Agriculture, Water and the Environment

By email: **FMDS.Evaluation@agriculture.gov.au**

Dear Sir/Madam

Evaluation of the Farm Management Deposits Scheme

CPA Australia represents the diverse interests of more than 168,000 members working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The internal **evaluation** (**the Evaluation**) into the operation of the Farm Management Deposits Scheme (**the Scheme**) being undertaken by the Department of Agriculture, Water and the Environment (**the Department**) reflects the Government's commitment to assessing the policy success and effective administration of the Scheme following the recommendations made by the Australian National Audit Office[1] (**ANAO**) and the Joint Committee of Public Accountants and Audit[2] (**JCPAA**).

Many of our members operate in regional and rural Australian communities and provide professional services such as tax advice, natural disaster assistance (e.g. climate change, drought, floods), cash flow management—including managing risks and unpredictable profitability—and supporting clients to access incentives and government support.

The Scheme is an initiative that is valued by the agricultural community. From the feedback we have received, our members believe that, overall, the Scheme serves its intended purpose. They recommend its continued operation. Agricultural production is one of the most variable and risk-prone industries with farmers exposed to significant uncertainty and volatility. During periods where production falls well below average, farmers' incomes are generally also well below break-even and the Scheme plays a significant role in helping to manage cash shortfalls.

Members have observed that farmers who hold deposits under the Scheme are significantly less stressed about their financial situation in poor-performing years. Other benefits of enabling farmers to better save income generated in good years include the ability to:

- Prepare for seasonal variations and climate change
- Better manage the cash flow implications of wild variations in commodity prices or risks to markets caused by decisions of Australia's trading partners
- Provide cashflow reserves to assist with investing in more efficient technology and environmentally beneficial practices
- Assist in ensuring that tax payments more correctly align with the long-term average returns to the business.

We make the following comments on the Evaluation's guiding principles.

1. The extent to which the Scheme meets its policy objective of assisting primary producers to become more financially self-reliant, as opposed to being utilised for other purposes, such as tax planning

The Scheme provides farmers with an income management tool that helps smooth the impact of income tax on their often-fluctuating incomes. As such, the policy delivers benefits to farmers through a tax concession. The suggestion that "tax planning" is a secondary or negative purpose is incorrect. In fact, effective tax planning through the legitimate use of tax concessions as a form of government support is the correct mechanism by which the intended policy outcomes are achieved.

[1] Commonwealth of Australia (2019). **Auditor-General Report No.51 2018–19 Performance Audit**, The Auditor-General, Australian National Audit Office, 26 June.

[2] Parliament of Australia (2020), **8. Auditor-General Report 51 (2018-19) Farm Management Deposits Scheme**, Report 481 Efficiency and Effectiveness: Inquiry into Auditor-General's Reports 25, 29, 38, 42, 44, 45 and 51 (2018-19), Joint Committee of Public Accounts and Audit, June.

The **quarterly Farm Management Deposit statistics** published by the Department of Agriculture reflect an increase in total balances every June, corresponding to the end of the financial year. During May and June each year, businesses review their financials, cashflow and tax liabilities, make company and trust resolutions and prepare for their end of year positions with their advisers. It is usually at this point in time that farmers will be in the position to decide whether to deposit monies into the Scheme, particularly given the restrictions on withdrawal. As such, the fluctuations in total balances are to be expected and are in line with the normal business cycle (i.e., in accordance with financial year end).

The Scheme's design is such that the tax benefits are limited to averaging tax liabilities over income years. Deducted deposits become assessable upon withdrawal and opportunities to defer income tax indefinitely are countered by the rules related to bankruptcy, cessation of primary production activities and death.

Feedback from our members is that the Scheme is an effective tool for providing financial security for those who are eligible. In terms of promoting 'improved self-reliance', the Scheme reduces the need for farmers facing financial insecurity to seek credit from lending institutions, often at high interest rates. It enables farmers to save more in well-performing years without being burdened by high tax liabilities.

Oversight is provided by the banking sector through dedicated accounts and the ATO's tax return reporting requirements, while the deemed repayment rules restrict the ability for taxpayers to manipulate the Scheme. We are not aware of any instances where the Scheme has been inappropriately used for tax avoidance. We therefore believe that the policy objective is being met in an appropriate way and that the risk of non-compliance is low.

2. What elements of the Scheme are working well, and what could be improved?

From an administrative perspective, our members have not raised any specific concerns. For most farmers, their primary interaction with the Scheme will be with the ATO, via their adviser, and in conjunction with their end-of-financial-year reporting and tax obligations. We recognise that there may be challenges co-ordinating the delivery of the policy between three departments – the Department of Agriculture, the ATO and the Treasury – however, we believe that the division of responsibilities has been appropriately allocated.

We note comments made by the ANAO and JCPAA in relation to risk assessment and compliance management. We support the ATO's responses to the Auditor General's report, particularly progressing opportunities to improve the quality and reporting of data. We believe that the ATO should seek to pre-fill, for individuals, the Scheme information required in the **supplementary tax return**. This will reduce the compliance burden for farmers.

3. Implications of the Scheme for Australian Government policies and programs, including those providing financial support to primary producers

From the profession's perspective, the key issues lie with the design of the policy and the fact that modern farming business structures and arrangements do not necessarily fit well with the Scheme's eligibility requirements.

While the Scheme is highly beneficial for those who are eligible and should remain available, we also recommend that the Government considers how best to support farmers in times of increasing commercial, climactic and economic challenges. As the scale and commercialisation of farming operations increase, the need to adjust or expand policy parameters is also increasing if the farm management deposits (FMD) system is to be adopted by farming enterprises.

We believe that policies should be accessible to all primary producers, regardless of operating structure, and should support their independence, resilience and growth. To this end, a holistic evaluation of tax and transfer payments available for primary producers should be considered, with changes made to broaden access to existing policies or the introduction of additional support. This may also include consideration of an extension of the Scheme to primary production business entities, rather than just individuals.

While we recognise the **Terms of Reference** limit the Department's ability to comment on the tax treatment, expansion to other business structures and thresholds, the Attachment contains comments on areas for potential improvement to the Scheme for consideration.

If you have any queries about this submission, please contact Elinor Kasapidis, Senior Manager Tax Policy, on 03 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

GAPflugrath

Dr Gary Pflugrath

Executive General Manager, Policy and Advocacy

CPA AUSTRALIA

The Scheme and trusts

Farm operations conducted through discretionary trusts or companies have their losses in a poor year locked in the trading entity and are unable to use them to offset the withdrawal from FMDs in their personal names. If an individual redeems a **FMD** and deposits the funds back into their operating family trust structure, because they've had a very poor year and are incurring a tax loss (rather than keeping the funds personally), then the redemption can be treated as income of the family trust and not of the individual.

Depositing money into FMD accounts when a trust is making a profit is of great benefit, in order to maintain capital and even out exceptionally good years, but it would be beneficial if the reverse can occur as well.

An additional improvement would be for the trustees of a discretionary family trust to be able to elect to claim a deduction for a FMD in the trust name, and treat redemptions as income, rather than being forced to flow it through an individual beneficiary.

The interaction with COVID support measures

There are quite a number of primary producers who would like to utilise the immediate write-off or full expensing of eligible assets to purchase new equipment to improve their businesses. Some would seek to do so by using existing FMDs to fund some or all of the purchase price rather than borrow additional funds from a bank/lender.

However, a particular feature of FMDs is that they must be held in the name of an individual. When the FMD withdrawal occurs, the income must be included in the individual's tax. But as the equipment must be purchased by the business (most commonly a company or trust) then the tax deduction is claimed by the entity and not the individual. As such, we may see circumstances where the business is operating at a loss which cannot be claimed by the individual, while having significant income in their personal tax return which is taxable.

Example

A primary production business is operating through a trust structure.

Two individuals (e.g. husband and wife) associated with the trust hold FMDs in their personal names of $200,000 each (total $400,000). In most cases the FMDs will have been accumulated over a number of years.

The business would like to purchase new equipment for $400,000 and use the FMDs to pay for the equipment rather than increasing borrowings.

If the trust makes a profit of $200,000, then purchases eligible equipment of $400,000, the result is a net loss to the trust of $200,000. This loss will be carried forward into future financial years until a profit is made in subsequent years (note: loss carry-back rules that may assist companies do not apply to trusts). However, the associated individuals each would have a taxable income of $200,000 and each would be required to pay a significant amount of tax on the FMD withdrawals.

As a result, they may choose not to purchase the equipment or would exercise a non-preferred approach of borrowing the funds when that may not be in their best financial interests.

Offset accounts

The ability to offset FMD deposits against bank loans is a useful tool. However, farming enterprises are increasingly operated, and have borrowings, through a company or trust structure. This means that many farmers are ineligible for the FMD offset.

The fact that both the loan and FMD offset account must be held in the individual's name to be eligible requires the individual to be the borrower, which may expose them to greater risks. This may include using non-business assets to secure/repay business debt. For example, a trust beneficiary FMD holder cannot offset that FMD against the business debt that is held in a trust (without partnership arrangements to purely meet this requirement).

Further, even when an FMD is eligible for an offset, the requirement is that the loan be wholly used (not mainly or principally) for business purposes to be able to then use the offset. Many farmers have consolidated debt facilities or bill facilities, and as they draw funds (past profits or distributions) from those facilities that are used for personal expenditure, the entire loan is compromised, and the offset is not available.

Death

FMDs held by an individual at the date of their death are assessable income in the financial year in which the death occurs. This can have adverse tax consequences for the deceased estate. This is particularly relevant with the increased FMD threshold of $800,000 per individual. An alternative may be for the estate to be able to elect to be assessed for tax in the year of receipt or averaged over 5 years.