
EXPOSURE DRAFT: IMPROVEMENTS TO THE FARM MANAGEMENT
DEPOSIT SCHEME

EXPLANATORY MATERIALS

Table of contents

| | | |
|-----------|---|---|
| Chapter 1 | Improvements to the Farm Management Deposit Scheme | 5 |
|-----------|---|---|

Chapter 1

Improvements to the Farm Management Deposit Scheme

Outline of chapter

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Banking Act 1959* (Banking Act) to improve the operation of the farm management deposit (FMD) scheme by:

- allowing taxpayers to consolidate multiple FMDs that they might hold with different banking service providers;
- raising the non-primary production income threshold; and
- limiting the rules in the Banking Act for unclaimed moneys to prevent them applying to FMDs.

Context of amendments

Farm management deposits

1.2 The FMD scheme is a financial risk management tool that, by smoothing tax liabilities, assists individuals who are carrying on a primary production business to deal effectively with fluctuations in cash flows resulting from climate and market variability. The rules are contained in Division 393 of the ITAA 1997.

1.3 Under section 393-5 of the ITAA 1997, individuals carrying on a primary production business (with a break of no more than 120 days) may deduct any FMD they make from their assessable income in the income year the deposit is made, provided:

- the FMD is not withdrawn within 12 months (the 12 month requirement – see section 393-40 of the ITAA 1997);
- the individual's taxable non-primary production income for the income year does not exceed \$65,000 (the non-primary production income threshold) (paragraph 393-5(1)(d) of the ITAA 1997);

- the individual does not die or become bankrupt during the income year (paragraph 393-5(1)(e) of the ITAA 1997); and
- the amount of the deposit does not cause the individual to exceed the cap on total FMD of \$400,000 (item 10 of the table in section 393-35 of the ITAA 1997).

However, an individual's deductions for FMDs in an income year may not exceed the individual's taxable primary production income for that year (section 393-5 of the ITAA 1997).

1.4 Withdrawals from FMDs are included in the FMD owner's assessable income in the year they are repaid and taxed at the owner's marginal tax rate (see section 393-10 of the ITAA 1997).

1.5 However, this will not apply to the extent that the withdrawn amount did not receive a deduction under section 393-5 of the ITAA 1997 when the deposit was made (that is, does not form part of the amount of the **unrecouped FMD deduction** – see subsection 393-10(2) of the ITAA 1997). Generally, an amount can be included in an FMD without the individual receiving a deduction under section 393-5 of the ITAA 1997 where the amount an individual deposited in FMDs in a year was later found to exceed the individual's taxable primary production income in that income year.

Consolidating FMDs

1.6 Since 1 July 2012, FMD owners may hold FMDs with more than one FMD provider. This change was intended to allow FMD owners freedom to choose where to establish new FMDs in order to allow them to negotiate competitive interest rates.

1.7 However, it has contributed to individuals holding multiple FMDs across a number of providers.

1.8 Division 393 of the ITAA 1997 contains special rules to prevent tax consequences arising where a FMD holder extends an existing FMD, reinvests it with the same provider or transfers it to a new provider (see section 393-15 of the ITAA 1997).

1.9 In these cases:

- repayments from an FMD do not result in amounts being included in individuals' assessable income (paragraph 393-15(2)(a) of the ITAA 1997);

- deposits into an FMD do not give rise to a deduction (paragraph 393-15(2)(b) of the ITAA 1997); and
- the requirement that FMDs not be withdrawn within 12 months does not apply (paragraph 393-15(2)(c) of the ITAA 1997).

1.10 When applying the 12 month requirement to a new FMD created as a result of these transactions, the requirement applies as if the new deposit was made on the day the original FMD was made.

1.11 Broadly, these rules ensure most transactions that do not in substance change the status of amounts held in an FMD do not result in tax consequences. However, these rules do not assist in consolidating multiple FMDs into a single FMD.

FMDs and unclaimed moneys

1.12 Section 69 of the Banking Act requires all ADIs to provide a report to ASIC detailing any amounts the ADIs hold that have become lost and unclaimed (including amounts held in FMDs), and to pay these amounts to the Commonwealth.

1.13 The legislation sets out various circumstances in which amounts may become unclaimed. In the case of bank accounts, the general requirement is that a period of three years must have passed since a transaction occurred.

1.14 Before 31 December 2012, the Australian Prudential Regulation Authority (APRA) had annually exercised its powers under section 11 of the Banking Act to prevent FMDs from becoming unclaimed moneys (see for example *Banking exemption No. 5 of 2011*).

1.15 However, on 31 December 2012, this exemption was allowed to lapse and instead subsection 69(1A) of the Banking Act has applied.

1.16 This subsection provides that an FMD will become unclaimed moneys if:

- no deposit into or withdrawal from the account has occurred for three years (or such other time as the regulations may provide); and
- after this time, the ADI has not been able to contact the owner of the FMD despite making reasonable efforts.

1.17 Amounts held by the Commonwealth as unclaimed moneys will be repaid if the Treasurer or an authorised officer is satisfied that the individual was entitled to that amount when it was held by the ADI. In this case, the amount (together with any applicable interest) will be repaid to the relevant ADI (or the ADI that has obtained their banking business if the former ADI has ceased to operate), which then must pay the amount to the individual.

1.18 An amount that is paid to the Commonwealth as unclaimed moneys does not regain its status as an FMD once it is repaid.

Consideration by the National Rural Advisory Council

1.19 The treatment of FMDs was recently considered by the National Rural Advisory Council (NRAC) in its Report on the Effectiveness of the Farm Management Deposit Scheme. NRAC noted that holding multiple FMDs may create an administrative burden for FMD owners and prevent them accessing to higher interest rates. NRAC recommended that the Government amend the legislation governing the FMD Scheme to allow FMD owners to consolidate FMDs that they have held for at least 12 months into a single FMD without triggering any tax consequences.

1.20 NRAC also considered the current non-primary production income threshold. Noting concerns around the increasing diversification of activities by farmers, NRAC recommended, amongst other things, an increase in the threshold from \$65,000 to \$100,000.

Summary of new law

1.21 The Government will amend the provisions of the ITAA 1997 relating to FMDs to:

- allow individuals with a number of FMDs to consolidate these deposits into a single deposit without facing adverse tax consequences; and
- increase the amount of taxable non-primary production income that an individual may earn in an income year before being prevented from accessing the FMD tax concessions

1.22 The Government will also amend the Banking Act to ensure that, going forward, amounts held in FMDs do not become unclaimed moneys.

Comparison of key features of new law and current law

| <i>New law</i> | <i>Current law</i> |
|---|---|
| Withdrawing and immediately re-depositing amounts for the purpose of consolidating FMDs does not give rise to income tax consequences and re-deposits are not subject to the normal restrictions on making FMDs provided all of the amounts are from FMDs more than 12 months old and gave rise to deductions when they were initially deposited. | The tax consequences under the rules for withdrawals and deposits from FMDs as well as the restrictions on making FMDs apply to transactions for the purpose of consolidating FMDs. |
| Taxpayers may not deduct the amount of a FMD they make in an income year if their taxable non-primary production income for the year exceeds \$100,000. | Taxpayers may not deduct the amount of a FMD they make in an income year if their taxable non-primary production income for the year exceeds \$65,000. |
| A FMD cannot become unclaimed moneys under the Banking Act. | FMDs can become unclaimed moneys under the Banking Act. |

Detailed explanation of new law

1.23 Schedule # to this Bill makes three principal amendments in relation to FMDs.

Consolidating farm management deposits.

1.24 First, Schedule # amends the ITAA 1997 to allow multiple FMDs of an individual, subject to the limitations and conditions specified below to be consolidated in a single account with one provider.

1.25 To facilitate consolidation, the normal income tax consequences of these transactions will not apply. [*Schedule #, item 10, section 393-16*]

1.26 As a result, where two or more FMDs are withdrawn and immediately redeposited in a new FMD (the consolidated FMD), amounts will not be included in an individual's assessable income for that income year as a result of the withdrawals.

1.27 Likewise the immediate redeposit of the withdrawn amount into the consolidated FMD will not result in the amount being deductible from the individual's income. [*Schedule #, item 10, subsections 393-16(1) and (2)*]

1.28 The amount redeposited will also not be subject to the restrictions on when individuals can make FMDs nor count towards the cap on the amount that can be deposited in FMDs in a year. *[Schedule #, item 10, subsections 393-16(1) and (2)]*

Limitations on consolidation

1.29 Only amounts that were part of an FMD (including a consolidated FMD) immediately prior to consolidation may be included in a consolidated FMD. The inclusion of any other amount in an FMD means that the new FMD is not a consolidated FMD and the normal tax rules for withdrawing and depositing FMD amounts applies. *[Schedule #, item 10, subsection 393-16(1)]*

1.30 In addition, certain amounts from FMDs may not be included in a consolidated FMD. If these amounts are included, the new FMD will not receive the concessional tax treatment for consolidated FMD. These excluded amounts are:

- amounts from FMDs that are less than twelve months old; and
- amounts that, while included in an FMD, did not give rise to an FMD deduction when the amount was deposited.

[Schedule #, item 10, paragraphs 393-16(1)(a) and (c)]

1.31 In both these cases allowing these amounts to be included would significantly increase complexity without being necessary to achieve the policy objective.

1.32 FMDs that are less than 12 months old are subject to special rules (see section 393-40 of the ITAA 1997). In particular, if an amount is withdrawn from an FMD within the initial 12 month period, the amount withdrawn is treated as if it had never been part of an FMD.

1.33 In the context of consolidated FMDs, applying this rule would require tracking all of the deductions relating to amounts included in the FMD as well as additional special rules around how these deductions are affected by withdrawals. Instead, amounts from FMDs less than 12 months old may not be included in a consolidated FMD. Individuals may later consolidate these amounts after the 12 month period has passed. *[Schedule #, item 10, paragraph 393-16(1)(c)]*

1.34 Amounts can be included in FMDs without giving rise to deductions where the amount of an individual's contributions to FMDs in an income year exceeds their taxable primary production income for that year (sections 393-10 and 393-35 of the ITAA 1997). As these excess

amounts have not given rise to a deduction, they also do not result in an amount being included in the FMD holder's assessable income when they are withdrawn (section 393-10 of the ITAA 1997).

1.35 While these amounts are held in an FMD account, they are not in substance an FMD; instead the legislation allows them to be held in an FMD account for convenience. Once the account is closed, this consideration no longer applies and there is no reason to allow these amounts to be redeposited into the consolidated FMD.

Special rules for consolidated FMDs

1.36 For most purposes a consolidated FMD will be treated in the same way as other FMDs.

1.37 However, consolidated FMDs are not treated as being made on the day the consolidation occurred. Instead they are considered to be the same age as the youngest of the FMDs from which amounts were consolidated. This ensures that the consolidated FMDs are not subject to the special rules that treat amounts withdrawn in the first 12 months after an FMDs is established as having never been part of an FMD. [*Schedule #, item 10, subsection 393-16(4)*]

1.38 Further, the unrecouped FMD deduction of a consolidated FMD is determined in a different way.

1.39 For FMDs generally, the unrecouped FMD deduction is equal to the amount of the deduction received under section 393-5 of the ITAA 1997 when the deposit was made until such time as any amount is withdrawn from the FMD. Once an amount has been withdrawn, the amount of the unrecouped FMD deduction is the amount of the unrecouped FMD deduction immediately prior to the withdrawal, reduced by any amount included in the owner's assessable income as a result of the withdrawal.

1.40 The unrecouped FMD deduction is the key mechanism by which FMDs achieve tax deferral. It ensures that the amount included in the individual's assessable income as a result of withdrawals will always be equal to the initial deduction that the individual received when the FMD was made.

1.41 However, a consolidated FMD specifically does not give rise to deduction when the FMD is created.

1.42 If the general rule applied, this would result in the inappropriate outcome that consolidated amounts could be withdrawn without resulting

in the inclusion of amounts in assessable income, making the tax deferral indefinite.

1.43 Instead, the special rule provides that the unrecouped FMD deduction of a consolidated FMD is equal to the sum of the unrecouped FMD deduction of the accounts that have been consolidated immediately prior to consolidation until an amount is withdrawn. As amounts may only be consolidated where the amount of the FMD is equal to the amount of the unrecouped FMD in respect of that deposit, the value of the unrecouped FMD of the consolidated account will be the same as the value of the consolidated FMD. As a result, all amounts withdrawn from an FMD will result in a amount being included in taxpayer's assessable income. *[Schedule #, item 10, subsection 393-16(3)]*

Example 1.1 Consolidating FMDs

Ms Bourne has owned and operated a farm in Western Australia since 2009. Over this time she has made 4 farm management deposits — a \$5,000 deposit made on 27 September 2010, a \$7,500 deposit made on 1 July 2011, a \$3,000 deposit made on 17 August 2012 and a \$10,000 deposit made on 30 November 2013.

For all of these deposits except the 1 July 2011 deposit, Ms Bourne was able to deduct the full amount of the deposit from her assessable income in the relevant income year. For these three deposits, the unrecouped FMD deduction is equal to the amount of the deposit. However, in 2011-12, Ms Bourne's primary production income was only \$5,000 so she was only able to deduct \$5,000 of the FMD she made in that year. As a result, for this deposit, the amount of the unrecouped FMD deduction is \$5,000.

In 20 July 2014, Ms Bourne wishes to consolidate all FMDs into a single FMD account.

This is not possible for two of Ms Bourne's deposits. The 1 July 2011 deposit has an unrecouped FMD deduction of less than the amount of the deposit, while the 30 November 2013 deposit may not be consolidated as it is less than 12 months old.

To allow the 1 July 2011 deposit to be consolidated, Ms Bourne withdraws \$2,500 — the amount of the initial deposit for which she did not receive a deduction. As the amount remaining in the deposit (\$5,000) is then equal to the unrecouped FMD deduction in respect of the deposit (\$5,000), the deposit may then be consolidated.

Ms Bourne chooses to consolidate the 27 September 2010, 1 July 2011 and 17 August 2012 deposits, withdrawing the deposits and immediately reinvesting them to create a new consolidated deposit of \$13,000.

The consolidated deposit is taken to have been made on 17 August 2012 and so is not subject to the special rules restricting withdrawals from new FMDs. It has an unrecouped FMD deduction of \$13,000.

On 30 November 2014, Ms Bourne's 30 November 2013 deposit is 12 months old. From this day forward, she may choose to further consolidate this deposit with her existing consolidated deposit.

Minor amendments

1.44 Minor changes have been made to a number of the provisions in Division 393 to definition and guide material to reflect the new provisions and amendments. These changes do not affect the operation of the law. *[Schedule #, items 6, 8, 9 and 11, notes 1 to subsections 393-5(1) and 393-10(1), note 1A to subsection 393-10(2) and the definition of 'unrecouped FMD deduction' in subsection 995-1(1)]*

Increasing the non-primary production income threshold

1.45 Secondly, Schedule # also amends the ITAA 1997 to increase the amount of taxable non-primary production income an individual can earn before being excluded from making FMDs from \$65,000 to \$100,000. *[Schedule #, item 7, paragraph 393-5(1)(d)]*

1.46 This addresses the concerns identified by NRAC that the existing threshold was limiting the availability of the concession as a result of the increasing diversification of the income generating activities of farmers and other primary producers.

Amending the application of unclaimed moneys rules

1.47 Finally, Schedule # also amends the Banking Act to exclude an FMD from becoming unclaimed moneys under the Banking Act. *[Schedule #, items 1 and 2, subsections 69(1A) and (1E) of the Banking Act]*

1.48 Due to their special tax treatment, FMDs are subject to a number of special conditions and restrictions. These include requirements that FMDs may not be transferred between owners and must immediately be repaid if the owner dies, becomes bankrupt or ceases to carry on a primary production business in Australia for more than 120 days.

1.49 The special requirements complicate the application of the unclaimed moneys rules. The unclaimed moneys rules operate on the basis that where there have been no transactions on an account within a certain period (broadly, three years), then the account holder has lost the account.

1.50 However, the conditions on FMDs mean that the owner and financial institution must remain in contact in order to be aware that the amount remains an FMD.

1.51 Further, the restrictions on deposits and tax consequences of withdrawal mean that there may be good reason why an individual does not undertake any transactions in relation to an account that is an FMD for a significant period.

1.52 Overall, the consequence is the application of unclaimed money rules to FMDs resulted in not insignificant compliance costs with limited benefits.

1.53 Given this, the Government considered FMDs should be excluded from the unclaimed moneys rules under the Banking Act to reduce the regulatory burden placed on individuals and financial institutions.

1.54 However, these amendments will not prevent amounts that have ceased to be an FMD (for example, because the owner has ceased to be engaged in a primary production business) from subsequently becoming unclaimed moneys.

Consequential and technical amendments

1.55 Schedule # also makes a minor technical amendment to remove a reference to FMDs in the rules for deductions of a company following a change in ownership set out in Subdivision 165-A of the ITAA 1997. *[Schedule #, items 3 to 5, paragraphs 165-55(5)(f) and 165-55(5)(j)]*

1.56 This technical amendment was made as the reference no longer has any effect. Only individuals may have an FMD or receive a deduction for making a contribution to an FMD. As a result there are no circumstances in which a company can have a deduction for a FMD in an income year to which the reference can apply.

Application and transitional provisions

Application

1.57 The amendments to allow consolidated FMDs and the increase to the non-primary production income threshold apply to assessments in income years commencing on or after 1 July 2014. *[Schedule #, item 13]*

1.58 Following this date, individuals may consolidate their FMDs, subject to the limitations and conditions outlined above, even where the FMDs may have been created in prior income years. Similarly, individuals with between \$65,000 and \$100,000 of income from sources other than primary production may make FMDs (provided they satisfy the other eligibility criteria).

1.59 The amendments exempting FMDs from becoming unclaimed moneys under the Banking Act are not subject to a special application rule. They apply from the day of Royal Assent. From this time, FMDs cannot become unclaimed moneys under the Banking Act. [*Schedule #, item 13*]

1.60 However, this will not affect the status of amounts that have already become unclaimed moneys, even if the amount was held as an FMD before being paid to the Government.

Transitional rules

1.61 These amendments also include a special transitional rule in the *Income Tax (Transitional Provisions) Act 1997* to clarify the tax treatment of amounts that were a FMD but have been paid to the Government as unclaimed moneys.

1.62 Generally, amounts withdrawn from FMDs are included in the owner's assessable income at the time they are withdrawn. However, the provisions do not specifically address cases where there is an involuntary transfer of the amount to the Government. As a result there is some ambiguity about when tax may arise.

1.63 The rule specifies that the repayment of the deposit will be considered to occur when the unclaimed moneys that was a FMD is repaid by the Commonwealth. The rule applies from 1 January 2013 (the first day on which FMDs can have become unclaimed moneys under the Banking Act). [*Schedule #, item 12, section 393-30 of the Income Tax (Transitional Provisions) Act 1997*]

1.64 This position is consistent with the current administration of the law. It ensures that there is no uncertainty that either the FMD is not be considered to be withdrawn when the FMD is paid to the Government as unclaimed moneys, which would require the amount be included in an individual's assessable income when they are unlikely to know about the matter. It also ensures that there is no uncertainty that an FMD becoming unclaimed moneys does not indefinitely defer the inclusion of the repaid amount in the individual's assessable income.

1.65 This transitional rule applies from 1 January 2013, the first date on which FMDs could become unclaimed moneys under the Banking Act. Prior to this day, FMDs were excluded under a series of exemptions issued by the Australian Prudential Regulation Authority (see for example, *Banking exemption No.5 of 2011*).

1.66 This provision applies retrospectively in this way to avoid any ambiguity that might arise in respect of the interpretation of the provisions before the clarification. Otherwise, it might be argued that, contrary to the intention of this amendment, the fact this amendment was made supported a view that the law worked differently prior to the clarification.