Grain Growers

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Submission: Changes to Farm Management Deposit scheme Draft Legislation, as per Agricultural Competitiveness White Paper

December 2015

Grain Growers Limited (GrainGrowers) is an independent and technically resourced, grain farmer representative organisation with 17,500 members across Australia. GrainGrowers' goal is a more efficient, sustainable and profitable grain production sector that benefits all Australia grain farmers and the wider grains industry.

We achieve this by:

- Having a strong policies and submissions process which is underpinned by our National Policy Group;
- Running education courses and events which help build human capacity and industry leadership skills; and
- Developing and distributing a wide range of products and services which directly benefit the industry.

Further information on GrainGrowers is available at:
http://www.graingrowers.com.au

This submission provides feedback on the exposure draft legislation and explanatory material associated with the implementation of the Australian Government's changes to the Farm Management Deposit (FMD) scheme, as announced in the Agricultural Competitiveness White Paper (http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Agricultural-Competitiveness-White-Paper-changes-to-Farm-Management-Deposits).

This submission provides feedback on the following improvements to the FMD scheme:

- a doubling of the deposit limit for FMDs from $400,000 to $800,000;
- the removal of legislative restrictions placed on financial institutions preventing FMD accounts being used as a farm business loan offset; and
- introducing early access provisions for farmers in severe drought.

GrainGrowers advocated for these improvements to the FMD scheme through both the Agricultural Competitiveness White Paper process and in response to the recent Tax Discussion Paper "Re: Think". The opportunity to now contribute to the implementation of these important changes is appreciated.

Yours faithfully,

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Introduction

The Australian Grains Industry is Australia's foremost commodity sector delivering annual farm production of $15bn, generating employment for more than 179,000 people across Australia and providing grains to Australia's domestic grain processing and livestock sectors. Australian grain growers sustainably manage around 22 million hectares to produce an average of 40 million tonnes of grain each year across Australia.

The grains industry is a fiercely competitive global industry with Australian grain farming businesses exposed to global markets and not heavily subsidised like international competitors. The international competitiveness of the industry is impacted by a range of domestic policy and international market measures often beyond the control of individual businesses.

Grain farming businesses are:

- Operating in volatile environment impacted by both production and commodity risk
- Often capital intensive, low margin operations, that are faced by either low profitability or high income variability across years
- By-and-large family owned operations that are increasingly requiring greater scale to increase profitability.

Taxation can have a critical impact on a business' international competitiveness depending on the rates applied versus its competitors and the comparative investment costs. Conversely, taxation can also be used to assist businesses under specific circumstances. As such, appropriate policy settings are therefore critical in ensuring the industry remains internationally competitive and is able to capture available market opportunities.

Compounded with an increased focus on self-reliance from Government policy and an increasingly variable climate, it is important that farmers have access to a suite of tools that can be utilised to help manage the volatility of farm production.

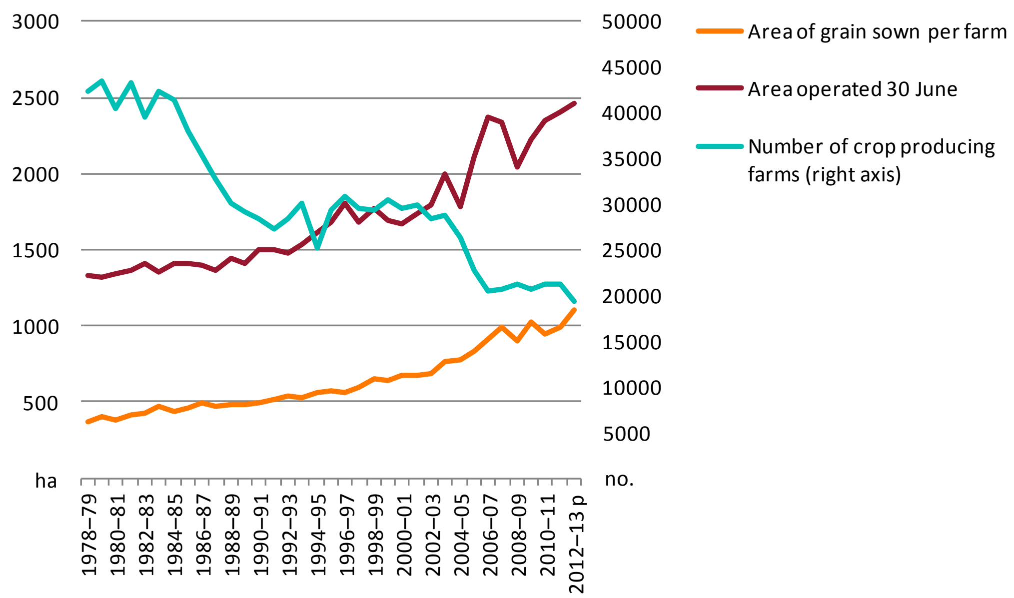
There are a range of taxation measures that support the industry in managing the inherent risks and volatilities in grain growing. In particular, the Farm Management Deposit Scheme (FMD) and tax averaging allow grain farming businesses to smooth income across a number of years while also providing opportunities to self-manage risk, particularly in times of drought. These policies are strongly supported by GrainGrowers, as are the recent improvements to the FMD scheme announced in the Agricultural Competitiveness White Paper.

Farm structures

The vast majority of grains farming businesses are family owned. Australia has a strong tradition of family owned and operated farms.

Since 1977–78 the average area of crops sown per farm has increased by an average of 3.3 per cent a year (Figure 1). The average area operated has also increased, although at the slower estimated rate of 1.8 per cent a year. Over the same period, the number of grain producing farms has declined at an average annual rate of 2.3 per cent[1].

Figure 1: Area sown to crops and number of farms, Australian grain producing farms, 1978–79 to 2012–13 average per farm



p Preliminary estimate.
Note: Crops include non-grain broadacre crops (such as cotton and hay).
Source: Australian Agricultural and Grazing Industries Survey

In terms of business structures, the National Rural Advisory Council (NRAC) Report on the effectiveness of the Farm Management Deposits Scheme reported that ABARES survey data indicated "around 5 per cent of broadacre farm businesses are operated in an incorporated business structure such as a company". Published ATO statistics are consistent with this, reporting that 5 per cent of entities in the agriculture, forestry and fishing industries in 2009–10 were companies.

[1] ABARES (Sept 2014), *Production costs in the Australian grains industry, 2010-11 to 2012-13,* pp13

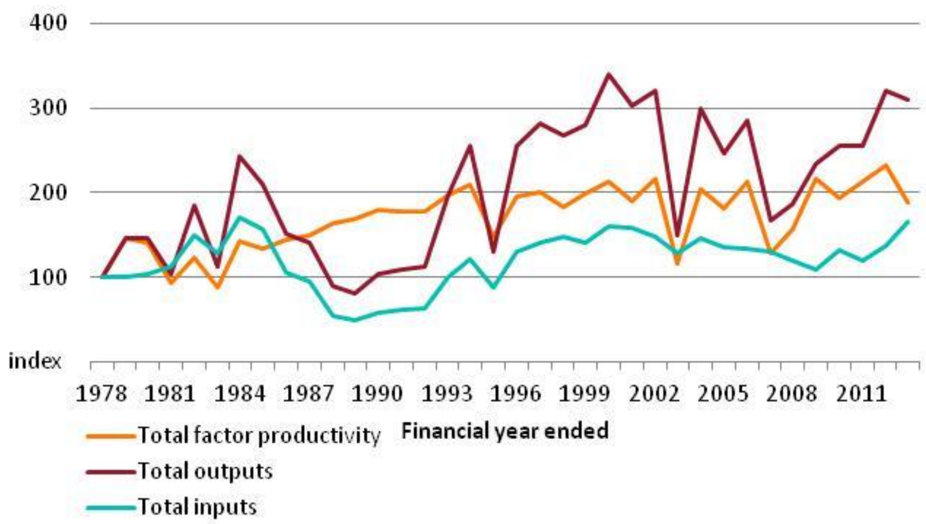
For non-corporate primary production, unpublished ATO data indicates that 57 per cent of farmers reported primary production income from partnerships in 2010–11. A further 28 per cent reported primary production income as a sole trader and 11 per cent through a trust. The remainder, less than 4 per cent, reported primary production income through some combination of partnerships, trusts and sole-trading arrangements.

Evidence from GrainGrowers members suggests there is an increasing trend away from partnerships towards trusts and companies. It is also important to note that those businesses in company and trust structures are likely to be larger and represent a greater proportion of farm output.

Productivity

According to ABARE's *Australian Grains - Outlook for 2015–16 and industry productivity* report cropping productivity grew by an average of 1.5% a year from 1977-78 to 2012-13[2]. This supports the growth of output of 2.6% over the same period with an input growth of 1.1%.

Figure 2: Trends in cropping specialists' total factor productivity, total inputs and total outputs, 1977–78 to 2012–13



Source: ABARES

Despite a slowing of productivity after 1988-89 and difficult and increasing variable seasonal conditions cropping has made significant industry-driven productivity gains[3]. An increasing use of digital technology (such as GPS), consolidation of smaller farms into larger enterprises, more efficient farming systems and different crop varieties are some of the reasons for an increase in cropping productivity.

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[2] ABARES (2015), *Australian Grains - Outlook for 2015–16 and industry productivity, pg.17.*

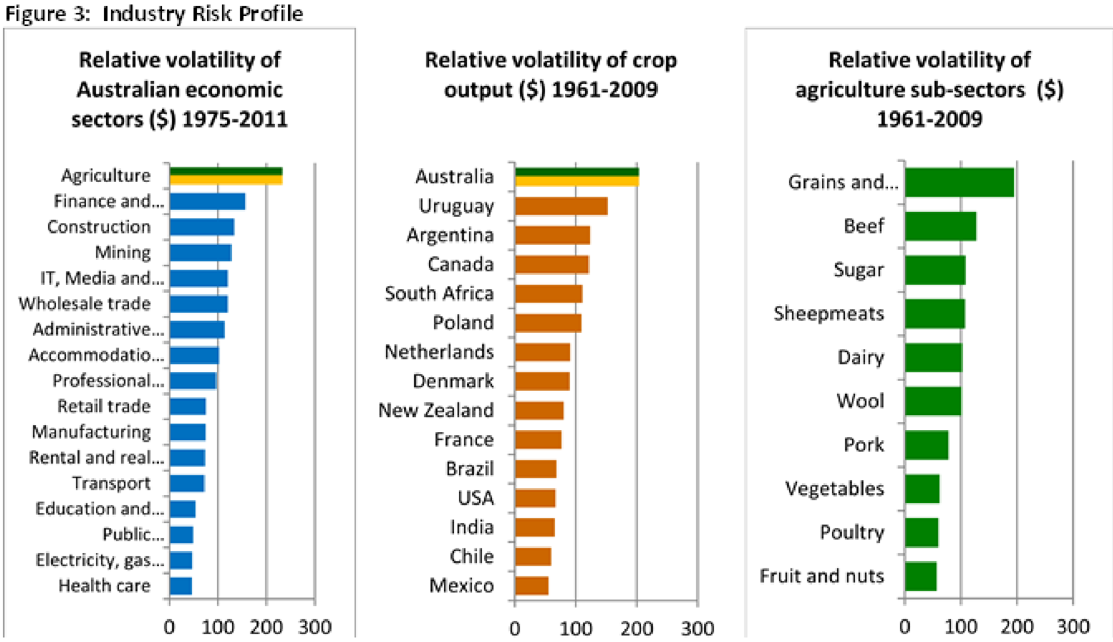
[3] ABARES (2015), *Australian Grains - Outlook for 2015–16 and industry productivity pg. 18.*

Agricultural volatility and risk

Agriculture, by its very nature, is highly volatile. When producing grain, farmers face two main forms of risk. Firstly, there is production risk, which is the risk associated with the generation of the actual crop. In short, this risk is largely associated with the volatility associated with climatic conditions, such as drought and is considered the greatest influencing factor on industry profitability. Secondly, farmers also face commodity price risk, which is affected by market conditions, and therefore the price farmers receive for their product. This is particularly relevant for grains where such a large proportion of product is exported. Often these risks are connected. For example, if one farmer has a poor crop, it is likely others will too, which may then reduce supply and push up grain prices. In recent years farmers have also faced policy risk such as in relation to climate policy or the Murray Darling Basin Plan.

The Australian Farm Institute[4] recently considered the risk in Australian agriculture, the extent to which it is different for different commodity sub-sectors, and the extent to which the risks have changed over time. The volatility of Australian agricultural production is the second highest in the world, and for crop production, the highest of any nation. The Australian agricultural sector is easily the most volatile when compared to other sectors in the Australian economy and is almost two and half times more volatile than the average for all sectors across the economy. Of the various agricultural sub-sectors, grains and oilseeds have been the most volatile of the last three decades. These findings from the Australian Farm Institute are demonstrated in Figure 3.

Figure 3: Industry Risk Profile



Source: Australian Farm Institute

[4] Australian Farm Institute (2012), *Farm Policy Journal, Autumn Qtr.*

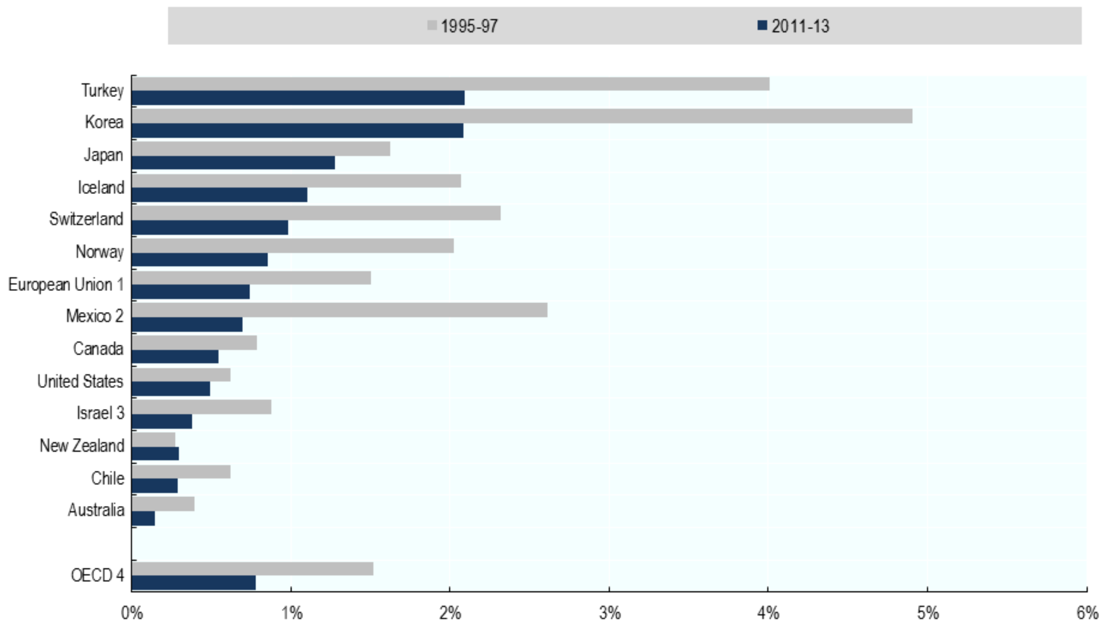
Industry support

While there is a small number of support measures from government that seek to smooth out some of the volatility inherent in grain production, such support is comparatively low compared to competitor nations. Indeed, the most recent report from the OECD found that Australian agriculture receives the lowest for any developed nation on earth, when expressed as a percent of national GDP (%TSE).

As highlighted in Figures 4, the total support measures (which include tariffs, subsidies, and funding for activities such as R&D) see Australia providing only 0.15% of GDP, which is the lowest in the OECD. When expressed by the producer support estimate (PSE) which is the percentage of farmer's income received a consequence of government support measures, Australia ranks second lowest in the OECD at about 2% of farmer's income. This compares to an OECD average of about 18%.

Figure 4 Total Support Estimate by country, 1995-97 and 2011-13

Percent of GDP



The importance of the FMD scheme

Given the factors noted above, the industry requires a variety of taxation tools that not only avoid adversely punishing the sector against its competitors, but also actively work to support international competitiveness of grain farming in Australia.

GrainGrowers strongly supports the ongoing provision of the FMD Scheme. The Scheme, implemented in 1999, is designed to increase the self-reliance of Australian farmers by helping them manage financial risk associated with climate variability and market fluctuations. It allows farmers to smooth their income over the longer term by making tax-effective deposits in higher-income years, which can be withdrawn as pre-tax farm income in later years. The scheme is consistent with the Government's objectives of encouraging farmers to have a greater self-reliance in managing drought and is particularly important given the increasing risks associated with climate change.

With exposure to a highly variable climate and to international market forces, FMDs allow farmers to more effectively manage the volatility of income derived from their farming operations. The scheme to date has been largely successful. Grains, as both pure grains and mixed grains-beef/sheep businesses account for some 43% of the total number of FMDs held and 47% of the value of total national deposits.[5]

A GrainGrowers member survey[6] during early 2015 provided a number of important insights into the scheme:

- Some 90% of respondents believed that the FMD as an important taxation tool to help manage volatile cash flow across years and almost 60% of respondents held an FMD account.
- For those that did not hold FMD accounts, 40% said that they had insufficient funds to contribute. A further 20% were restricted in that they operated under either a trust or company structure.
- In relation to scheme improvements:
    - 50% of respondents proposed exploring novel changes to improve scheme functionality, such as the ability to use FMDs as an offset account
    - 50% urged expansion to allow access to those operating under a trust or company structure
    - Almost 45% urged Government to increase the $400k cap and a further 25% proposed increasing the off-farm income test beyond the $100k cap

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[5] Department of Agriculture and Water Resources, Farm Management Deposits Scheme Statistics, October 2015 Figures.

[6] GrainGrowers Member Survey, 'Tax-FMD's', 430 survey participants, May 2015, results available at: http://www.graingrowers.com.au/images/30_policy/member%20survey%20tax%20-%20fmds%20micro-survey%20results%202015.pdf

Comments on specific updates to FMD Scheme

Increase in FMD cap

The increase in the FMD cap from $400,000 to $800,000 is a welcome update to the FMD scheme. The costs involved with running a successful modern farming business are ever increasing. There are a number of drivers for this, including an increase in scale and ever increasing input costs (such as fuel, fertiliser, chemicals and labour). Lifting the cap is reflective of changes in modern agricultural businesses and is an appropriate policy update. Beyond this update, there may be value in regular reviews of thresholds to keep pace with a changing farm business environment.

This amendment to the FMD scheme seems relatively straightforward and is supported as proposed.

Consequences of early withdrawal of FMDs because of severe drought

Under the proposed changes, an amount withdrawn from an FMD within a year of its deposit does not lose its taxation treatment as an FMD if prescribed rainfall conditions are met for a prescribed period. The principle of this amendment, as advocated by GrainGrowers, is welcomed. However, the details around the eligibility criteria require further consideration.

This change is returning a previously available FMD functionality that was unfortunately removed as part of the abolition of Exceptional Circumstances. It is also recognising that droughts, like other natural disasters, may require farmers to withdraw FMD's earlier than anticipated. This early withdrawal is also available for farmers who are currently accessing, or have accessed, primary production Category C assistance under the Natural Disaster Relief and Recovery Arrangements.

Allowing farmers to access their FMD funds within 12 months of depositing, without worrying about taxation implications, is in line with Government policies encouraging a greater level of self-resilience in managing drought. The approach of each farmer who considers early FMD withdrawal will be different and there is likely to be a range of scenarios that play out. Keeping this in mind, the scope of qualifying primary producing businesses seems reasonable (noting earlier comments in the submission regarding access for farm businesses operating in company or trust structure).

Rainfall conditions for early withdrawal

It is proposed that the qualifying primary production business must demonstrate that any part of the land of the business has experienced a rainfall deficiency for at least six consecutive months and the deficiency must be equivalent to or worse (i.e. lower) than five per cent of average rainfall (one in twenty year event) for that six month period based on the most recently available publicly released data from the Bureau of Meteorology at the time of the withdrawal.

While the 'one in twenty year event' threshold seems reasonable, the appropriateness of a six-month rainfall deficiency requires further consideration. An administratively simplistic threshold lacks consideration of the complex drivers of crop growth such as effective growing season rainfall (timeliness), extreme temperature events, soil water retention capacity, hail and frost. As an example of a more adequate system for considering how farms are affected by drought, the Australian Drought Monitor[7] provides some food for thought.

The accuracy of the system may also come under question in its ability to reflect actual received rainfall on-farm when applied in areas where weather stations are widely dispersed – this is particularly the case for many cropping regions.

The six-month time period also raises questions of fairness, given a six month period in isolation may not sufficiently meet the 'one in twenty' threshold. The timing of the FMD deposit is also important, which may not always align with rainfall events.

Unfortunately, there may be farmers in need who miss out on eligibility for early withdrawal of their FMD due to these factors.

These issues also plague other Australian Government drought support measures and ultimately should be considered in a holistic review of the ability of farmers to access drought and risk management assistance measures.

It is also noted that an assessment on ABARES Monitor[8] tool will be required for eligibility. The requirement for farmers to have to use yet another tool from another Government agency website is likely to compound confusion over the myriad of risk management tools available to farmers. As an example, if a farmer was in the midst of severe drought and exploring available support measures they would be required to look at different climate maps, provided by different agencies for the drought concessional loans/drought recovery concessional loans and the FMD early withdrawal provisions – this is in addition to any possible state measures which may require a climatic threshold.

[7] http://www.graingrowers.com.au/products-services/drought-monitor
[8] http://www.agriculture.gov.au/abares/monitor

Use of FMDs with qualifying primary production loan offset accounts

Following positive member feedback, GrainGrowers advocated for consideration of the ability for funds held within an FMD account to act as an offset against farm loans. The announcement of this measure through the Agricultural Competitiveness White Paper was strongly welcomed. This change potentially reduces the interest payable for farm businesses when they require capital. Finance sector participation in the delivery of this measure is required and is hopefully forthcoming following the required legislative amendments.

The limitations on the offset facility for loans that are used wholly for the purpose of that business seem reasonable, as the intention is to reduce debt on farm business operations.

The application of the administrative penalty of 200 per cent of the amount by which interest has been reduced on the portion of the loan subject to the non-qualifying purpose requires further clarification. For example, within a family farming business, term debt may be sought to help run the farming business, but also to help meet family living expenses or purchase of personal items. It is not clear whether a proportion of a loan can be offset, or whether it must be an entire loan. Further clarification on this matter and other potential scenarios will be required to help avoid confusion and encourage greater compliance once available.

One of the challenges of the proposed changes will be in situations where FMD accounts are held in a different name to existing business loans, for example in a family farming business partnership. Further, with the growth in the number of farm businesses moving to company and trust operating entities, this may require further consideration. Without further exploration and resolution of this issue the usability of an offset function will be limited.

Other updates required to FMD scheme

Going forward, there is value in Government considering the case for FMD access for businesses operating in company and trust structures; improving the tax rules for non-commercial losses and the treatment of FMDS; and exploring how to improve the usability of FMDs for farmers nearing retirement, including the interaction with the superannuation system. GrainGrowers would welcome the opportunity to work with Government in progressing these updates.

Conclusion

With over $1.8 Billion[9] held in FMDs by grain and mixed grain-sheep/beef, it is clear the FMD scheme provides a valuable tax measure to help manage the variable incomes associated with cropping in Australia.

Regular updates to the FMD scheme are required and the changes proposed in the Agricultural Competitiveness White Paper are supported by GrainGrowers.

There are a few implementation issues that require further consideration, as outlined in the above submission. However, overall the Australian Government must be congratulated for progressing these important changes to a critical risk management tool for Australian grain farming businesses.

9 Department of Agriculture and Water Resources, Farm Management Deposits Scheme Statistics, October 2015 Figures.