Chapter 3
Schedules 2 and 3

3.1 The Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 (the bill) makes changes to the treatment of cross-border transactions between businesses and amends rules relating to Farm Management Deposit accounts (FMD).

Schedule 2

3.2 The changes proposed in Schedule 2 are technical amendments to *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). The bill proposes to amend the circumstances in which a non-resident entity is required to register for GST in Australia.

3.3 These changes enact recommendations of the May 2010 Board of Taxation (BOT) report—*Review of application of GST to cross-border transactions*—on the application of Australia's GST to cross-border transactions, and Australian Government Budget initiatives from 2010–11 and 2012–13 Budgets. The BOT report found that Australia's GST system is overly inclusive of non-residents which can place unnecessary compliance costs on non-residents.[1]

3.4 The justification for the proposed changes in Schedule 2 can be found in the BOT's aforementioned 2010 report:

> Non-resident businesses can be drawn into Australia's GST system because of the 'invoice-credit' mechanism which seeks to tax the valued added at each stage of the production chain on a transaction by transaction basis. To ensure that no GST is borne by businesses on their inputs, businesses are required to register for GST to claim a refund of the GST paid. In order for non-residents to claim a refund of the GST they have paid, they are required to register and so are drawn into Australia's GST regime.
>
> This gives rise to administrative costs for non-residents and integrity concerns for the ATO, which has limited jurisdictional control over non-residents. In addition, if non-residents do not register and claim their input tax credits, there is the potential for GST to be 'embedded' in the price of the supply.[2]

3.5 Schedule 2 proposes changes to improve the balance between ensuring that Australia's GST system does not unnecessarily draw in non-residents while maintaining the existing GST base. The changes proposed in Schedule 2 do not alter

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1 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 69.

2 The Board of Taxation, *Review of application of GST to cross-border transactions*, 2010, pp. 5-6.

the tax base. The changes are anticipated to result in decreased regulatory burden in complying with Australia's tax laws.[3]

3.6 The committee heard concerns from Lloyd's—an insurance market—that the proposed changes would create difficulties for some members of the insurance industry as it provides services to businesses and consumers whose tax affairs are treated differently. This may have the potential of increasing compliance costs for insurers and their clients.[4] Lloyd's has also made these concerns known to Treasury and Australian Taxation Office.[5]

3.7 Lloyd's also expressed concerns that in the current climate of tax scrutiny, where many people believe large companies do not pay their fair share of taxation, these amendments have the potential to create a negative impression on non-resident entities appearing to be tax free.[6]

3.8 The committee received one submission relating to this schedule, discussed above.

Schedule 3

3.9 The bill proposes to change the administration of FMDs, which were introduced in 1999 to replace the Australian Government's Income Equalisation Deposit and Farm Management Bond Schemes.[7] The proposed changes received general support from the submissions received by the committee.[8]

3.10 Farm Management Deposit accounts assist primary producers to manage risks from fluctuations in primary production income over multiple financial years. FMDs allow primary producers to carry over income from years of good cash flow for use in later years. This smooths income tax liabilities over seasonal fluctuations and economic events. Income deposited into an FMD is treated as an income deduction in the year of deposit, and is later assessed as income when the funds are withdrawn.[9]

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3 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 67.

4 Lloyd's, *Submission 2*, p. 5.

5 Lloyd's, *Submission 2*, p. 2.

6 Lloyd's, *Submission 2*, p. 6.

7 Department of Agriculture and Water Resources, *Information for New Farm Management Deposit Holders*, http://www.agriculture.gov.au/ag-farm-food/drought/assistance/fmd/info (accessed: 10 March 2016).

8 Tasmanian Farmers and Graziers Association, *Submission 6*, p. [1]; Australian Honey Bee Industry Council Inc., *Submission 5*, p. 1; National Farmers' Federation, *Submission 1*, p. [6].

9 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 120.

3.11 Around 35,000 primary producers own around 45,000 FMDs holding approximately $4 billion in assets. Approximately 10 per cent of primary producers in Australia currently hold an FMD.[10]

Reviews of Farm Management Deposit accounts

3.12 Reviews of the FMD scheme were conducted in 2002 and 2006 by the then Department of Agriculture, Fisheries and Forestry and in 2012 by the National Rural Advisory Council.[11]

3.13 The 2002 review recommended that the scheme continue in its present form for at least another three years, with no other notable recommendations.[12]

3.14 The 2006 review found that the scheme was contributing to the financial resilience of primary producers by giving them an effective risk management tool:

> By providing a tax based instrument that increases farmers commercial options through income smoothing and liquidity management, the FMD Scheme has been used for risk management purposes. Used in this way, FMDs promote better and timelier resource allocation decisions. For instance fertiliser is more likely to be applied when best needed rather than simply in the year high income is earned. Better farm management decisions are entirely consistent with better risk management decisions. Timely investments make the farm more financially viable and sustainable to cope with downturns due to climate variations or market fluctuations when they occur. Simply put, there is less risk that a farm will fail financially if poorly timed expenditure can be avoided. 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.[13]

3.15 In response to one of the 2006 review's recommendations, the Australian Government increased the deposit cap from $300,000 to $400,000.[14]

3.16 In 2012, the National Rural Advisory Council conducted a review (NRAC Review), finding that '[t]here is no doubt that the scheme is an important tool for farmers across Australia'.[15]

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10 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 140.

11 Department of Agriculture and Water Resources, *Reviews of the Farm Management Deposit Scheme*, http://www.agriculture.gov.au/ag-farm-food/drought/assistance/fmd/review (accessed: 10 March 2016).

12 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 7.

13 Department of Agriculture, Forestry and Fisheries, *Farm Management Deposits*, 2006, p. 4.

14 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 7.

3.17 The NRAC Review recommended in 2012 that the FMD cap on deposits be retained at $400,000, 'as it is not considered to be a barrier to farmers participating in the scheme in the current operating environment'.[16] The review recommended that the cap be reviewed every three years, noting that changes to input costs, farming practice, and the likelihood of increasing climatic variability:

> …would inevitably put more pressure on the cap and, in turn, may reduce the scheme's capacity to help farmers have cash available to ride out or recover from downturns, such as drought.[17]

3.18 The current cap of $400,000 for FMDs has not been updated since 2006–07 and has not been indexed since that time. The EM argued that doubling the cap 'would better meet the objective of encouraging primary producers to improve their resilience by building up additional cash reserves'.[18] The Regulatory Impact Statement (RIS) noted, however, that 'the effectiveness of the increase in the cap will be constrained by the number of primary producers that have the financial capacity to put aside amounts over $400,000'.[19]

3.19 Increasing the deposit limit to $800,000 is expected to have a cost to revenue of $20 million over the forward estimates period.[20]

3.20 The NRAC Review recommended that the Australian Government 'consider including an exemption mechanism in developing and implementing its package of drought-related programs'.[21] The proposed changes to the early access provision (discussed in greater detail below) appear to enact this 2012 recommendation.

3.21 The Australian Government released the *Agricultural Competitiveness White Paper* (the Paper) on 4 July 2015. The Paper contained a number of policies to strengthen the agricultural sector including improving the tax system for the agricultural sector and facilitating more effective risk management strategies for primary producers.[22]

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15 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 2.

16 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 21.

17 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 21.

18 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 141.

19 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 142.

20 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 147.

21 National Rural Advisory Council, *Report on the effectiveness of the Farm Management Deposits Scheme*, 2012, p. 23.

22 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 119.

3.22 Citing unpublished figures from the Australian Bureau of Agricultural and Resource Economics and Science, the Paper reported that if all FMD holdings are used to offset loans, farmers could save primary producers $150 million a year in interest costs.[23]

Key Provisions of the bill

3.23 Schedule 3 makes amendments to the *Income Tax Assessment Act 1997* (ITAA Act) to amend the rules for FMDs.

Increased deposit limit

3.24 Currently FMDs may not have a balance of more than $400,000 in total at any one time. The bill proposes to increase the maximum amount that can be held in FMDs by a primary producer up to $800,000. The EM explains that:

> This enhances the capacity of the FMD framework to assist primary producers to manage seasonal fluctuations in cash flow, including extended periods of positive or negative cash flow.[24]

3.25 The National Farmers' Federation (NFF) supported this view, noting: 'An update of the deposit cap reflects the changes required to operate a modern farming business and allows farmers to better manage future risk.'[25] The NFF also called for regular reviews of the FMD criteria to ensure they maintain their real value.[26]

Early withdrawal due to drought

3.26 The bill also makes provisions allowing primary producers experiencing severe drought conditions to withdraw money in an FMD within 12 months of its deposit, in the income year following deposit, without having to amend the preceding year's income tax treatment of the FMD. Under the current arrangements the FMD owner is required to amend their previous year's income tax assessment to remove the deduction claimed for the amount deposited.[27]

3.27 The definition of severe drought is based on publicly available data from the Bureau of Meteorology. 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.[28] The rainfall deficiency is equivalent to a one in twenty year event; or less than 5 per cent of average rainfall for that

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23 Australian Government, *Agricultural Competitiveness White Paper*, p. 24.

24 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 123.

25 National Farmers' Federation, *Submission 1*, p. [8].

26 National Farmers' Federation, *Submission 1*, p. [8].

27 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 121.

28 The rainfall deficiency test period can be prescribed by regulations. Until such a regulation is made the period is six consecutive months.

six month period.[29] The withdrawn money must have been in the FMD for the entire six month period covered by the drought event, and any future deposits in that financial year are not treated as FMDs.[30]

3.28 The NFF suggested that the six month measure of drought conditions may be problematic, citing an example that shows that using a nine-month below-average drought window would enable more farmers to access the early withdrawal facility in some circumstances.[31] Dr Lindsay Campbell argued the proposed definition of a drought might not be appropriate, and the use of a median and standard deviation measure may provide a more accurate representation of drought.[32]

3.29 The early withdrawal provisions only apply to businesses likely to be adversely effected by drought. Commercial fishing, pearling, felling of trees and related industries are not included.[33]

3.30 The Australian Honey Bee Industry Council Inc. noted that drought is not the only natural disruption that can negatively affect primary production. The recent bushfires in Tasmania for instance may place beekeepers in financial hardship for several years to come while the natural environment recovers.[34]

Use of FMDs to offset other debts

3.31 Presently funds in FMDs are unable to be used to offset interest owing on debts associated with the operation of a primary production business. The bill proposes to allow amounts held in an FMD to offset a loan or other debt relating to the FMD owner's primary production business.

3.32 The loan that is offset against an FMD must relate wholly to a primary production business carried on by the FMD owner either directly as a sole trader or through a partnership. The concession provided by these amendments does not extend to loans held by companies, trusts or a person who is not the FMD owner.[35] The NFF expressed concerns that access to this provision might be limited as loans are often held in the name of the business, not the individual or partnership.[36] According to the EM, financial institutions indicated that 'there would be significant complexities and

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29 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 121.

30 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, pp. 126-7.

31 National Farmers' Federation, *Submission 1*, p. [8].

32 Dr Lindsay Campbell, *Submission 3*, p. 2.

33 The farming of aquatic animals is a qualifying class of primary production for the purposes of early withdrawal. Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 125.

34 Australian Honey Bee Industry Council Inc., *Submission 5*, p. 1.

35 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 129.

36 National Farmers' Federation, *Submission 1*, p. [9].

costs for them if they were to allow an FMD owner to offset a loan held by another entity'.[37]

3.33 The EM highlighted stakeholder concerns regarding the difficulties of establishing offset arrangements for FMDs:

> [F]inancial institutions were concerned with the policy and highlighted complexities and compliance costs that would be imposed on them from making the change. Financial institutions were not clear on whether they would offer FMDs as a loan offset.[38]

3.34 The NFF also expressed concerns that the new arrangements might create prohibitive administrative burdens for producers, depending on how financial institutions implement these changes.[39] The EM notes:

> Financial institutions will not need to offer FMDs as loan offset accounts and so the change allows financial institutions and primary producers to determine what arrangements are most suitable for them.[40]

3.35 Only loans directly related to the primary production business can be offset using funds in an FMD. If the loan that is offset relates partly to a primary production business, and partly to other purposes, administrative penalties may apply in respect to the portion of the loan relating to the other purpose or activity. The EM outlines the penalties and justification:

> The amount of the administrative penalty is equal to 200 per cent of the amount by which interest has been reduced on the portion of the loan used for non-qualifying purposes. The effect of the penalty is to remove any benefit from using an FMD loan offset for a non-qualifying purpose while also imposing an additional cost to act as a deterrent to taxpayers to enter into such arrangements and recovering the time-value of any benefit the taxpayer may have obtained through non-compliance.[41]

3.36 There is no restriction on the type of loan or other debt that an FMD can be offset against, provided the liability is solely related to the primary production business.[42]

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37 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 148.

38 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 148.

39 National Farmers' Federation, *Submission 1*, p. [8].

40 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 148.

41 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 131.

42 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 130.

Committee view

3.37 The committee supports the proposed changes to FMD accounts, which will give primary producers greater flexibility in managing risks to their business.

3.38 The early access provisions for drought conditions are an important amendment to ensure primary producers can use FMD accounts to address risks to their business caused by extreme weather events without undue compliance costs. The committee encourages the Australian Government to monitor the effectiveness of the early access provisions in the bill to ensure they are meeting their intended objectives.

3.39 The committee notes that drought is not the only extreme environmental event that threatens primary production businesses. The Australian Government may wish to consider increasing the scope for early access provisions for producers such as bee-keepers whose income can be threatened from natural disasters such as bushfires.

Recommendation 1

3.40 The committee recommends that the Senate pass the bill.

Senator Sean Edwards

Chair