MLC TechConnect

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How Farm Management Deposits can help your farmer clients

This article discusses how Farm Management Deposits can assist farmers with their cashflow.

Background

Farm Management Deposits are a risk management tool to help farmers deal with uneven income, which is common in agriculture because of natural disasters, climate and market changes.

How does this scheme work?

The Farm Management Deposit (FMD) scheme allows farmers to claim a tax deduction for deposits they make into the scheme in the financial year they made them.

If the farmer subsequently withdraws from the scheme, the amount of the previous deduction they redraw is included in their assessable income in the financial year the deposit is repaid to them. The operation of this account ensures that income is averaged out over multiple financial years.

The scheme complements other risk management strategies available to primary producers, such as financial planning, developing fodder and water reserves and diversifying production systems.

Who is eligible?

To be considered as a primary producer, the farmer must be an individual carrying on a primary production business in Australia which includes animal and plant cultivation (such as a dairy farm, pine plantation, beef cattle lot), fishing, tree farming and felling.

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Farmers must have non-primary production taxable income up to $100,000 in the financial year of making the deposit.

Tax concession requirements

To qualify for the concessional tax treatment, the FMD must:

- be deposited with a financial institution under an agreement that describes the deposit as an FMD and satisfies certain conditions
- be made by a person that is a primary producer at the time of making the deposit

- be at least $1,000, and the total FMD must not exceed $800,000 at any time, however, the owner can have FMDs in more than one financial institution (ie bank, building society or credit union)
- be held for at least 12 months to retain FMD status
- be owned by an individual (including a partner in a partnership or beneficiary of a trust) and is non-transferable. For example, a deposit by a trust, company or individuals jointly will not be an FMD, however, a trustee may make an FMD for a beneficiary who is under a legal disability if the beneficiary is presently entitled to that portion of trust income (eg minors). Companies and other entities are not eligible for an FMD
- not be used as security or a have a charge created over it
- have earnings paid to the owner before it can be deposited back into the FMD
- not be decreased by any administration fee or charge levied by the financial institution in relation to the FMD.

Deposits made into FMDs

Eligible farmers need to make sure that their:

- deposits are at least $1,000, and
- total account balance keeps below $800,000 at any time.

Any deduction the farmer claims cannot be more than:

- the deposits they made, and
- their taxable primary production income for the financial year.

Interests offset with FMDs

Generally, any interest earned on an FMD must be paid to the owner, not into the FMD. Interest earnings on the FMD are included as assessable income and not counted as primary production income. However, owners can use interest on amounts held in an FMD to offset interest on a loan or debt that meets all of the following conditions:

- FMD account is linked to the farmer's loan account through an offset arrangement
- farmer conducts their primary production business as either a sole trader or in partnership
- account being offset (the debt or loan) relates wholly to their primary production business (not someone else's business).

Where these conditions are met, the interest earned is not assessable income and the interest saved on the loan is not deductible.

Example 1 – interests offset with FMDs

Penny has a business loan of $400,000 for her grain growing business. She also has an FMD account a balance of $100,000. Her bank provides an interest offset facility, allowing her FMD account balance to be considered when the interest is calculated on her outstanding debt. The calculations are:

- Loan account balance: $400,000
- FMD account balance: $100,000
- Loan interest calculated on: $300,000 (ie $400,000 - $100,000)
- Loan interest rate: 6.00% p.a.

Calculation of monthly interest repayment:

[(Net position × applicable interest rate) ÷ 365 days] × days in the month

[($300,000 × 6.00%) ÷ 365] × 30 = $1,479.

Penny cannot claim a deduction for any more than $1,479 for the month.

Withdrawal of FMDs

FMDs can contain both deductible and non-deductible deposits. Receiving repayments of deposits that have not been claimed as a deduction (or non-deductible deposits) are not considered to be assessable income. When farmers receive a repayment, they are considered to have withdrawn any non-deductible deposits first. It is the farmer's responsibility to keep track of the different amounts in their FMD.

Farmers should provide their tax file number (TFN) or Australian business number (ABN), otherwise, any repayments may be subject to the top marginal rate of withholding tax and any applicable levies, such as the Medicare levy.

FMDs are deemed to be repaid when an FMD owner:

- becomes bankrupt
- stops carrying on a primary production business for 120 days or more, or
- passes away.

In these cases, the repayment will be assessable income if a deduction was claimed when it was deposited.

Withdrawal of FMDs within 12 months

An FMD that is withdrawn within the first 12 months after the date of deposit will lose FMD status from the deposit date. This means that any deduction that was previously claimed in the year of deposit is lost and must be amended via adjusting their previous tax return.

Any remaining amount, not withdrawn, still qualifies for an FMD deduction, provided:

- it remains in the account for at least 12 months, and
- it does not fall below $1,000.

Early access provisions

Farmers affected by natural disasters can withdraw their FMDs within the first 12 months of deposit without losing any previously claimed tax deductions, due to certain natural disasters or severe rainfall deficiency. For more information about these early access provisions and for qualification conditions, please refer to the **ATO's Farm Management Deposit Scheme.**

This exception is only available where a deposit has been made in one financial year and withdrawn in the next financial year, within a 12 month period. That is, farmers can retain the tax benefit claimed for the FMD in the previous year, but the amount of the withdrawal becomes part of the farmer's assessable income in the financial year they withdraw the FMD.

The provision is not available to farmers who make the deposit and withdrawal in the same financial year, as the tax benefit associated with that FMD has not been claimed through an income tax return. If a farmer withdraws their FMDs under the early access provision, they cannot claim a tax benefit for any further FMD deposits made later in that financial year.

Example 2 – Deposit partly paid within 12 months

On 1 November 2022, Angela, a farmer, made an $8,000 deposit into an FMD account. For the financial year ended 30 June 2023, Angela claimed an FMD deduction of $8,000. On 1 August 2023, Angela withdrew $5,000 from her FMD account. The withdrawal was not in connection with a natural disaster or severe rainfall deficiency.

The $3,000 that remains in her FMD account still qualifies as an FMD deduction if it remains in her account until 1 November 2023. The $5,000 she withdrew does not qualify and is considered never to have been part of her deposit. As a result, Angela has to request an amendment for the financial year ended 30 June 2023 to reduce her FMD deduction claim by $5,000.

Example 3 – averaging out income

Adam, aged 45, is a primary producer and his income comes only from primary production. In 2022/23 his assessable income was $100,000. This created a potential tax liability of $24,967. On 1 April 2023, Adam contributed $40,000 to an FMD. Accordingly, the deposit reduces his assessable income to $60,000 with a tax liability of $11,067.

In 2023/24, Adam's taxable primary production income is likely to be $3,000. Adam requires funding for the next crop and is planning to withdraw the $40,000 from the FMD in June 2024, more than 12 months after making the deposit. As a consequence, Adam's assessable income for the 2023/24 year is $43,000 with a tax liability of $5,147. The table on the following page illustrates his tax liability before and after the FMD.

Financial year	Taxable income	*Tax liability	Taxable income after $40,000 FMD	*Tax liability after $40,000 FMD
2022/23	$100,000	$24,967	$60,000	$11,067
2023/24	$3,000	$nil	$43,000	$5,147
Total	**$103,000**	**$24,967**	**$103,000**	**$16,214**

* Tax liability includes Medicare levy and Low income tax offset.

Adam can reduce tax by depositing excess funds from the 2022/23 year for use in the 2023/24 year. The amount he saves is $8,753 ($24,967 - $16,214).

Reinvestments and consolidations

Rollovers (or reinvestments) from one FMD to another provider or the same provider are not considered as deposits (ie deduction) or withdrawals (ie assessable income).

Two or more FMDs may be consolidated into a single FMD. The withdrawals involved in consolidating the accounts will not be counted as a deposit or withdrawal if the following conditions are met:

- Original FMDs only contain amounts for which deductions have been claimed.
- Original FMDs are immediately reinvested into a single FMD. This can be with the same FMD provider or a new FMD provider.
- After merging, the consolidated FMD only contains amounts that have been:
  - held for at least 12 months
  - claimed as a tax deduction.

Social security

An FMD is assessed as a financial asset and is deemed under the social security means tests. Withdrawals from the account are not assessed as income.

Although making an FMD reduces taxable income, the gross amount of income (ie excluding the FMD) is still assessed for social security purposes. Similarly, a withdrawal is not assessed as income for social security purposes.

Estate planning

FMD are non-transferrable to other individuals and upon death, the FMD must be repaid in the relevant financial year and the value, previously claimed as a tax deduction, must be included as assessable income in the deceased's income tax return up to the date of death[1].

Any tax payable is incurred by the estate, and not necessarily the beneficiary who actually receives the funds. The payment of this additional tax could significantly reduce the value of another beneficiary's gifts from the estate (particularly if the balance of the FMD is high).

Advice tips

1. Ideally, FMDs should be regularly withdrawn over time which will allow for a lower average tax rate and ultimately means that by the time of the farmer's death, all or most of the funds have been withdrawn.
2. Remember that an FMD is an asset of the individual primary producer (as opposed to an asset of the farming business entity). As such, it is important that the terms of the Will are drafted (considering both the farming business and the FMD) in such a way to ensure that the FMD goes to the right beneficiary as intended.

[1] SECT 393.10 of ITAA 1997

Conclusion

If clients are farmers with uneven income, an FMD account may help to average out their income. You should understand the rules for FMDs before implementing as part of a strategy. In particular, while a client's tax liability may be reduced in the financial year of deposit, tax liability may increase in the financial year of withdrawal. Most importantly, the farmer must seek advice from a qualified tax adviser and estate planning specialist.

Contact details

For further information, please contact TechConnect on **1800 645 597**