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Financial planning for primary producers

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In terms of managing farm operations there are a multitude of financial considerations, including:

- debt repayment and lifestyle goals
- off-farm investments
- planning/budgeting for farm acquisitions
- re-forecasting as conditions and/or prices change.

Financial advisers can help farmers to obtain an accurate and complete picture of farm performance and connect them with other relevant parties such as accountants, bankers, farm consultants and lawyers.

This paper explains the types of things that financial advisers specialising in agricultural businesses help clients with on a daily basis.

Farm succession

Farm succession is usually the 'elephant in the room', but also one of the greatest challenges facing farmers Australia-wide. There is no single easy solution, and families and farms can be destroyed if not undertaken properly.

Farmers want to ensure that the family farm is passed onto the next generation while making sure the business stays viable and profitable. The best-case scenario is that the retiring farmers have an adequate income and some provisions are made for the non-farming children.

Due to the intricacies of family groups, it is very important that farmers receive personalised financial planning advice, tax and legal advice.

Self-managed superannuation

A self-managed superannuation fund (SMSF) is a private superannuation fund, regulated by the Australian Taxation Office (ATO), that people manage themselves or with the assistance of trusted advisers. SMSFs can have up to four members. All members must be trustees (or directors if using a company trustee) and are responsible for decisions made about the fund and for compliance with superannuation rules.

An SMSF can provide more control over investments and can invest in other assets such as shares, property (including primary production land), managed funds, cash/term deposits etc.

Example 1. SMSFs to buy primary production land

An SMSF can acquire a farm from its members and carve out the homestead from the transaction to allow it to retain its tax exemption as principal place of residence.

The main benefit of using superannuation as a tax structure is that it is taxed on a concessional basis with a maximum rate of 15% and in retirement as low as 0% (up to a maximum of $1.6 million per member).

Personal and farm protection

Farmers, just like any other small business owners with debt and financial dependants, should have sufficient protection in place if

something unforeseen should happen. Some insurances can be paid through superannuation, which can be a tax-effective option.

Life cover (death cover)
Such cover provides a capital payment in the event of death. This payment can be used to clear/reduce debts and to fund income requirements for the family.

Total and permanent disablement cover
This cover provides a capital payment in the event of an accident or illness which prevents someone from ever working again at their own or any other occupation (policy wordings differ). This can be used to pay for medical expenses or changing the home or car to cater for a disability, debt reduction and to fund income requirements for the family.

Income protection
Income protection cover pays an ongoing monthly payment if a person is unable to work due to sickness or injury. A person can normally get up to 75% of income after expenses, depending on financial history and profitability.

Critical illness (trauma)
Such cover provides a capital benefit upon diagnosis of a specified illness or injury, for instance, cancer, heart attack, stroke etc. This can provide a benefit to reduce debt, help pay for uninsured medical expenses or used to employ someone to undertake particular work duties.

Cash flow and farm management deposits

Farm management deposits (FMDs) are very useful and help primary producers deal with uneven cash flow. FMDs allow farmers to set aside pre-tax income in years of good cash flow to draw on in years of lesser cash flow. Some special rules apply to withdrawals made during a severe drought or natural disaster.

A positive change is that the government now allows farmers to use FMDs to offset any farm loans. This means that instead of being paid interest, a person can be saving interest from their borrowings. This can provide a much better financial outcome for most farmers, however, there is only one bank currently offering such a product.

FMDs or superannuation?
It is common for farmers to ask if they should put money into FMDs or superannuation. The short answer is it depends what a person is trying to achieve. However, there are strategies that will improve what farmers can do in the future.

As mentioned, an FMD scheme is a way primary producers can deal with uneven cash flows. Uneven income is quite common in primary production due to things like market variables and the weather. Farmers can hold up to $800,000 (assuming eligibility) per person in FMDs and not pay income tax until funds are withdrawn. Further, they must have no more than $100,000 in taxable non-primary production income in the income year they make the deposit.

Example 2. Reducing taxable income through FMDs
Thomas and Sally have an outstanding year and sell a large number of cattle. During this time, their income is $1.8 million. They know the future years will not be this good, so they put $1.6 million into FMDs ($800,000 each). Thus, their taxable income is $100,000 each.

Another way for people to reduce tax is through superannuation. Superannuation is just a tax-effective vehicle to save for retirement. Once money is in the superannuation environment can be invested into shares, property, cash or even more primary production land, depending on a fund member's risk tolerance and preferences.

Primarily, superannuation savings cannot be accessed until a member reaches their preservation age and retires, or if they reach age 65 and have not retired, or transition to retirement from preservation age. A person's preservation age depends on the year in which they were born. This information is available on the ATO website.

It is usually recommended that people start contributing at least something into superannuation so that they can benefit from compound interest over time. Contribution amounts would depend on a person's cash flow and whether they are carrying any farm debt, or how quickly they are paying it down.

In the preceding example, Thomas and Sally could deposit $15,000 each into superannuation, and their taxable income would reduce to $85,000 each.

In July 2018, the government introduced a change so that previous years' contributions can be used through 'catch-up concessional contributions'. Thus, if a person's superannuation balance is below $500,000 and they have not used their total concessional contributions cap for the last few years, they can carry the amounts forward and make a larger tax-deductible contribution to superannuation.

Debt reduction and cash flow

Cash flow is the key to survival of any farm or business. Most farmers have experienced some form of financial stress, so it is very important to have a budget and work out a budget plan. The key is to seek advice to balance debt repayments with other strategies such as FMDs and superannuation etc.

While interest rates are low, a desirable move is to pay down as much debt as possible. This reduces risk of default and lets most farmers sleep a lot easier at night. Once debt levels are at an acceptable level, it may be possible to look at another farm acquisitions or some off-farm investments.

The quote

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Diversifying and reducing risk

Investing in assets such as property and shares away from a farm can be an effective strategy to diversify and reduce risk. This greatly reduces exposure to factors such as weather cycles and commodity price fluctuations. It is also much easier to sell a parcel of shares in a period of severe drought then it is sell a farm.

Off-farm investments can also be used to equalise an estate if one beneficiary wants to work on the farm but another beneficiary does not.

When times are good, farmers sometimes want to continue buying more land to grow the farm. This can be an effective strategy, but it does also come with more work and risk.

Funding education expenses

Children's, and sometimes grandchildren's, school and university fees can be expensive. Further, boarding fees can make things even more expensive. It is essential to start planning early and investigating strategies to make sure funds for education are available when required.

Example 3. Family succession trusts

Family trusts can be a useful tool to hold assets or property for the benefit of someone else. Trusts can be used to assist with farm succession, to protect family assets and can also divide income to minimise tax. Family trusts have many intricacies, and it is always best to seek specific legal and tax advice on the implications of buying or moving assets into trusts.

Software resources

On a granular level, there are specialist farm management software tools that can assist with production planning, budgeting and administration in areas such as:

- benchmarking against farms with similar operations
- 'scenario planning' (i.e. assessing profitability and cash flow impacts of changes to particular strategies)
- integrating budgeting and stock-on-hand positions with profit and loss (e.g. working out which areas are doing well and which areas are barely breaking even on a dollars-per-hectare, per-carcass-weight basis and more)
- stock reconciliation and bank reports.

Taxation

Farmers can take advantage of tax averaging to allow for the good and bad years. Tax averaging evens-out income and tax payable over a maximum of five years to ensure that primary producers do not pay more tax over a number of years than taxpayers on comparable but steady incomes. Farmers can also claim depreciation on any plant and equipment used on the farm. There are special rules for fencing, water facilities and fodder storage. Finding a good accountant who works with other farmers is paramount.

Conclusion

Life as a farmer can be extremely tough and lonely, but also tremendously rewarding. Many farmers would not have it any other way. Advisers can help farmers realise their idea of financial freedom by building and protecting their family wealth in often challenging circumstances and allowing more time to focus on ways to improve their farm and lifestyle. FS