AIATSIS
Australian Institute of Aboriginal and Torres Strait Islander Studies

Worldwide knowledge and understanding of Australian Indigenous cultures, past and present

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

9 October 2008

Re: review of Australia's tax system

The Australian Institute of Aboriginal and Torres Strait Islander Studies (AIATSIS) has a research focus on the taxation of native title settlements. Our work in this area is undertaken by the Native Title Research Unit (NTRU).

The work, initiated originally by a request from Treasury, has involved consultation and partnerships with Native Title Representative Bodies, Indigenous trusts and mining and other industry groups, state governments and tax law professionals. AIATSIS has engaged in awareness raising and knowledge transfer exercises including a pro bono advice panel, workshops and conferences and development of materials and resources. These activities are supported by the Department of Families, Housing, Community Services and Indigenous Affairs, and include research partners at the University of Melbourne Agreements Treaties and Negotiated Settlements Project, and the University of New South Wales Aurora project.

The taxation of native title is poorly understood by native title groups, government parties, proponents and policy makers. There are outstanding questions in terms of how benefits received as a result of native title agreements should be treated and how this may impact on Indigenous individuals and communities under the current tax transfer system.

The purpose of this submission is to identify the current challenges in the taxation framework that may impede Indigenous economic development within the native title context, through unnecessary complexity and ambiguity that have led to perverse choices and suboptimal outcomes. We make recommendations for an alternative framework designed to provide simplicity and clarity in this area and maximise the economic and social stimulus of native title and native title settlements. The submission includes a summary addressing the key issues, as well as materials produced over two years relating to the taxation of native title.

The Review team will no doubt be aware of related inquiries of the House of Representatives Standing Committee on Aboriginal and Torres Strati Islander Affairs inquiry into Indigenous enterprise and Minister Macklin's Working Group on Native Title Payments.

Thank you for the opportunity to provide input to this inquiry. If you would like further information on this submission, please contact Dr Lisa Strelein, AIATSIS Director of Research, on 6246 1155 or lisa.strelein@aiatsis.gov.au.

Yours sincerely,

Dr Lisa Strelein
Director of Research

Submission summary

Native title has the potential to be a key economic driver in remote and regional Indigenous communities where native title settlements have provided opportunities for negotiated agreements, business development, education and employment. However, the disjunction between the unique legal nature of native title under the *Native Title Act 1993* (Cth) (NTA) and normal operation of taxation legislation and policy has lead to inefficient outcomes.

Ambiguity in the current taxation system in relation to Indigenous native title rights and interests has lead to a number of questions related to the extent to which native title agreements should be classed as compensation, the 'value' of settlements, capital revenue distinctions and the flow-on effect of native title on members of the native title group.

To date, Indigenous groups have opted to structure their agreements and asset holding bodies in order to minimise engagement with complex tax decisions, often in suboptimal or overly complex structures to ensure that native title assets are protected and benefits arising from rare economic opportunities are maximised.

Although special regimes are sometimes considered an anthema to good tax policy and system design, there needs to be scope and flexibility within the tax transfer system to accommodate the unique nature of native title ownership. The alternative route is potentially highly litigious. All native title parties agree that more litigation in native title is not desirable and that scarce government resources are better spent in settling the 600 hundred outstanding native title claims.

There are number of alternative taxation models that can be adopted in order to simplify the taxation of native title payments and benefits. These issues can be addressed through the following recommendations for reform:

- Compensation for the impairment of native title should be defined and specifically exempted from the Income Tax and GST regimes consistent with other forms of compensation payments.
- A zero rated native title withholding tax should apply to a class of native title agreements acknowledging that the transaction may come under the current tax system while recognising that related payments would not normally be taxed.
- Distributions made under native title agreements should be subject to the *Social Security Means Test Treatment of Private Trusts – Excluded Trusts Declaration 2005*.
- Amendments to Division 30 and 50 of the *Income Tax Assessment Act 1936* should be made to establish a new category of tax exempt and deductible gift recipient for Indigenous and native title corporations/funds with a community development purpose.
- There should be options available to Indigenous native title communities to accumulate funds to reflect the intergenerational nature of their assets.
- Incentives or beneficial flow-on effects could also be provided to encourage capital investment in Indigenous organisational and joint ventures

A specific regime addressing the distinct features of native title can not only recognise native title as a unique right but also maximise rare opportunities that native title can provide for Indigenous economic development.

Major challenges facing Australia that need to be addressed through the tax transfer system

From an economic policy perspective, it now well established that Indigenous people are among the most economically marginalised and impoverished citizens of Australia. Dr Ken Henry, Secretary to the Treasury, has begun to examine the complex social and economic policy framework that is required to improve the wellbeing of Indigenous people, in the context of the Treasury's overall mission to 'improve the wellbeing of all Australians'.[1]

Henry has acknowledged the visible economic disadvantage in remote Indigenous communities and the limited economic opportunities that may be available in these regions. Indigenous people have not benefited from general, sectoral or local economic growth. In particular there is limited if any demonstrable flow on effect from resource and other developments even where those developments occur on their traditional lands.

Native title has the potential to be a key economic driver in remote and regional Indigenous communities, where the vast majority of native title has been determined, through negotiated agreements, business development-related employment and the potential social and educational spin-offs. But these agreements may come around only once. Tax policy can play a role both in creating incentives for investment as well as maximising the benefit of native title payments, particularly in relation to price sensitive agreements.

While native title agreement-making cannot support Indigenous economic development alone, it has a key role to play in terms of injecting funding, investment and infrastructure into Indigenous communities where there may otherwise have been little or no investment.

Henry makes the link between the need for simplicity and clarity in policy solutions that break down the 'Himalayan' pile of paperwork. He is critical of the way in which 'the mountains of red tape simply bury the limited administrative resources available at the local level'.[2] This is particularly the case in relation to the interplay of tax and native title, no doubt two of the most complex legal regimes in Australia.

The work conducted by AIATSIS over two years has revealed the difficulties experienced across the native title sector, including governments and industry, as well as native title groups, in navigating the complexity and ambiguity. While AIATSIS has worked with the sector to develop better practice and improve the information base in this area, there are options for reform that would improve the overall system by reducing complexity and providing certainty.

[1] Ken Henry, Secretary to the Treasury (2007a), 'Addressing Extreme Disadvantage Through Investment in Capability Development', Australian Institute of Health and Welfare Conference: 'Australia's Welfare 2007', 6 December 2007 pp. 15-16: <http://www.treasury.gov.au/documents/1327/RTF/Health_and_Welfare_Conference.rtf>. See also Ken Henry, Secretary to the Treasury (2007b), 'Creating The Right Incentives For Indigenous Development', Cape York Institute Conference 'Strong Foundations – Rebuilding Social Norms In Indigenous Communities', Cairns, 26 June 2007: <http://www.treasury.gov.au/contentitem.asp?NavId=008&ContentID=1275>.

[2] Henry 2007a, p. 17.

What features should the system have in order to respond to these challenges?

There needs to be scope and flexibility within the tax transfer system to accommodate the unique nature of native title ownership. A specific regime addressing the distinct features of native title can not only recognise native title as a unique right but also maximise rare opportunities that native title can provide for Indigenous economic development.

First, there is a rationale for native title to be considered as unique and distinct for tax purposes. In other jurisdictions, such as Canada and the United States, the unique status of native title as emerging from the laws and customs of the Indigenous people, as prior sovereigns, is recognised as placing transactions concerning those rights outside the taxation system. The tax exemption is supported by the judicial theory of Aboriginal title (in many respects common to all three jurisdictions) but is yet to be tested in Australia. While these comparative models are not easily translated into the Australian context, there is a clear rationale for native title to have a sui generis regime to avoid decades of litigation trying to 'fit' native title into our traditional conceptions of property and income.

Second, the recognised gap in the economic and social wellbeing of Indigenous peoples may warrant further measures to allow settlements from native title and other developments to provide maximum benefit to affected Indigenous communities and recognise the unique development challenges facing those communities. There are existing models within the tax system that could be adapted to recognise and support the diverse development needs that confront Indigenous communities as well as models that create incentives or conditions to maximise economic stimulus of rare economic opportunities.

What are the problems with the current system?

Native title has the following particularities that raise challenges for the interpretation of tax treatment:

- Native title is a communal and intergenerational asset that recognises and protects prior sovereign property rights;
- Native title is said to be legally sui generis, or unique, unlike other property rights known to the common law;
- Native title under the common law is inalienable except to the Crown;
- The commercial potential of native title is curtailed by common law and the NTA;
- Native title groups have no right to say no to an act authorised by the Crown.
- The rights of native title holders where the Crown chooses to act in relation to their land are, in most circumstances, limited to notification and consultation but, where significant impact of extinguishment is required a right to negotiate may be triggered;
- The Crown's duty to consult and pay compensation is largely delegated to proponents under the NTA; and
- Negotiations under the NTA are compulsory for both native title groups and third parties.

Other issues that impact on native title settlement outcomes include:

- Native title agreements are often bound up with other social and policy goals of corporate and government proponents;
- Resources available to Indigenous groups for expert advice and services are severely limited

and focused around claims resolution. Native title groups often rely on proponents to resource negotiations and provide tax/corporate advice; and
- Despite the involuntary nature of most native title agreements, Indigenous groups have sought to exercise economic agency in negotiating agreements.

Ambiguities in the tax treatment of native title arise in relation to, for example:
- the extent to which native title payments are 'compensation';
- the capital/revenue distinction in native title payments;
- uncertainty regarding the impact of the legislative principle of 'non extinguishment' of native title on the nature of events;
- the 'value' of native title agreements;
- when native title groups are engaged in enterprise; and
- how communal assets and activities relate to native title organisations (eg as trustees) and native title group members (eg as beneficiaries).

These issues are discussed in detail in the accompanying reports.

In many circumstances, Indigenous groups have opted to structure their agreements and asset holding bodies in order to minimise engagement with complex tax decisions and ensure that benefits arising from rare economic opportunities are maximised. For example, many groups opted to channel settlement funds into a charitable trust. However, this has been shown to result in suboptimal choices in the use of funds resulting from the migration of potential economic opportunities into narrow social/charitable uses. The multiple purposes of some larger scale settlements have resulted in overly complex structures that place impossible administrative loads on already overburdened community resources.

While the ATO has been able to produce clear direction in relation to compulsory acquisition of native title (which constitute the minority of agreements),[3] there is little clarity in other circumstances.

What reforms do we need to address these problems?

The need for greater clarity and simplicity in the tax treatment of native title payments is a key policy motivator and the primary purpose of this discussion paper. Attempting to untangle the 'right' tax treatment from the complex environment of native title has proved more than difficult. There is clearly a rationale for a special tax regime for native title that can provide the necessary certainty.

1. Specific exemptions for compensation
Because of the unique nature of native title payments made for the loss or impairment of native title and the impact on the exercise of native title rights and interests could be defined as compensatory and specifically exempted from the Income Tax and GST regimes, including interest and revenue generated from those funds, with provision for roll overs and distributions.

2: Native Title Withholding Tax
In 1998, the then Federal Treasurer proposed the implementation of a withholding tax on all 'native title payments'.[4] The proposal was never implemented due to the conceptual issues identified

[3] See GSTR 2006/9. [88] and [85-89].

above. Modelled on the Mining Withholding tax under section 128U of the ITAA 1936, the withholding tax would be pegged at a rate that estimates the revenue stream at risk – for the MWT this is currently 4%.[5]

The structure of native title agreements are different to those contemplated by the MWT. Financial benefits for Indigenous parties often are in the form of compensation which would not normally be taxed. In addition, as discussed, agreements and settlement often incorporate corporate and government benefits that would otherwise be provided.

It may therefore be necessary to impose a zero or nominal rating. Moreover, a withholding tax should be applied to class of agreements rather than payments, and including any agreement that involves a process under the native title act. A zero rating also avoids the issues of apportionment and valuation that currently plague the sector.

3. Alternatives to charitable trusts

A study of the aspirations of native title groups reveals the complex matrix of disadvantage and development needs of Indigenous communities. This correlates to a broad range of potential uses for native title settlements, including the management and protection of their native title lands and waters, health care, maintaining cultural and community programs, education, employment and training and economic and business development.[6] There is, at present, no single vehicle that can meet the various purposes identified by native title groups in a tax effective way. Yet, most of these purposes are individually recognised as potentially tax exempt entities under the ITAA.

The tax policy of granting tax exemptions to bodies carrying out activities that are beneficial to communities should be extended to Indigenous native title holding bodies and Indigenous organisations carrying out a range of community development projects.

These purposes may, in light of the dire state of Indigenous economic marginalisation, extend to projects that promote economic development or business development and support services where return benefit the native title community as a whole. In any event they should at least include a single entity or fund undertaking activities to promote community development, health, environment, culture and religion, education. Division 30 and 50 of the ITAA should be amended to establish a new category of tax exempt deductible gift recipient.

The intergenerational nature of native title and the scarcity of economic opportunities should be reflected in an appropriate accumulation model.

4. Social security means testing exemption

Distributions made under native title agreements by PBCs (and any new structures designed for the use and management of settlements) should be subject to the *Social Security Means Test Treatment of Private Trusts – Excluded Trusts Declaration 2005*. The declaration provides a model for exemption based on a dominant purpose test of the tax entity as well as a means of dealing with the flow on effects of distributions. Native title trusts can easily fall under the definition in section 5 of

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[4] 'Taxation Implications Of The Native Title Act And Legal Aid For Native Title Matters', Media release, The Treasurer, The Hon. Peter Costello MP Attorney-General The Hon. Daryl Williams AM QC MP, 13 February 1998

[5] Strelein explains this further – pg 55.

[6] Lisa Strelein and Tran Tran, *Native Title Representative Bodies and Prescribed Bodies Corporate: native title in a post determination environment*, Native Title Research Report No.2/2007; and Toni Bauman and Tran Tran, *First National Prescribed Bodies Corporate Meeting: Issues and Outcomes Canberra 11-13 April 2007*, Native Title Research Report No.3/2007.

the declaration which defines a community trust as a trust that has the sole and dominant purpose of receiving, managing or distributing income that has been created from Indigenous held land applied for a community purpose'. However, greater clarity on this issue is needed. Native title is arguably an interest in land analogous to the definition provided by s 4B of the *Aboriginal and Torres Strait Islander Act.* Community purpose includes a purpose that is intended to benefit primarily members of a particular community or group which is broad enough to include activities such as economic development.