Australian Government

Native Title, Indigenous Economic Development and Tax

Consultation Paper
October 2010

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Consultation Process

Request for feedback and comments

The Government is seeking feedback and comments on the issues outlined in this consultation paper. The information obtained through this process will inform the Government's approach on the way forward.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in-confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: Tuesday, 30 November 2010

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FOREWORD

I am very pleased to resume this discussion paper on native title, Indigenous economic development and tax.

The Government is committed to ensuring a more flexible, less legalistic approach to native title that delivers practical outcomes for Indigenous Australians. The tax system can play a valuable role in this area by ensuring that it supports the resolution of claims and the management of benefits under native title agreements.

In response to concerns that the potential income tax implications of native title claims are complex and uncertain, the Government plans to consider options for reform in this area. This consultation paper outlines three approaches:

- an income tax exemption;
- a new tax exempt vehicle; and
- a native title withholding tax.

The ability for non-legislative approaches (such as the provision of guidance material) to reduce complexity and improve certainty will also form part of the Government's consideration.

Consistent with the Government's commitment to closing the gap on Indigenous disadvantage, this consultation paper also discusses how existing deductible gift recipient categories could be better adapted to reflect the needs of Indigenous communities.

Consultation plays a valuable rule in developing changes to the tax law and I look forward to receiving the views of the community on these important issues.

SIGNED

The Hon Bill Shorten MP
Assistant Treasurer and Minister for Financial Services and Superannuation

1. OVERVIEW

The Australian Government is committed to ensuring a more flexible, less legalistic approach to native title that delivers practical outcomes for Indigenous Australians. Over many years, a range of stakeholders have raised concerns about the interaction between the income tax system and native title. A central theme of these concerns is that the potential income tax implications of native title claims are complex and uncertain.[1]

During 2010, the Government intends to consider reforms that provide greater clarity and certainty on how the income tax system and native title interact. In this context, the Government will also decide how to proceed in relation to the native title withholding tax and capital gains tax measures announced by the previous government in 1998. These measures remain unenacted.

This consultation paper:

- provides an overview of how the current income tax law may apply to payments made under agreements recognised by the *Native Title Act 1993*;
- describes the approaches the Government intends to consider; and
- discusses some of the benefits and limitations of these approaches from the perspective of native title groups and industry.

State taxes and other Commonwealth taxes are beyond the scope of this paper.

The Government has also received a range of proposals to use the tax system to promote Indigenous economic development. Direct spending programs are ordinarily better suited to providing support for this important Government priority. However, the consultation paper invites comment on the ability of Indigenous communities to access general tax incentives such as deductible gift recipient status.

Consultation questions appear throughout the paper to assist stakeholders in considering how different options may impact on their particular circumstances. Stakeholders are also encouraged to provide feedback on their experience with the interaction between the tax and native title systems. This feedback will assist the Government to decide how to proceed.

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1 For example, concerns about the interaction between the income tax system and native title were raised in the report of the Native Title Payments Working Group. The report, and the Government's subsequent Native Title Discussion Paper, are available from the websites of the Attorney-General's Department (www.ag.gov.au) or the Department of Families, Housing, Community Services and Indigenous Affairs (www.fahcsia.gov.au).

2. Native title groups

2.1 Introduction

The complexity and uncertainty that native title holders and claimants (referred to throughout as native title groups) face in relation to the income tax treatment of payments made under native title agreements are the result of a combination of factors.

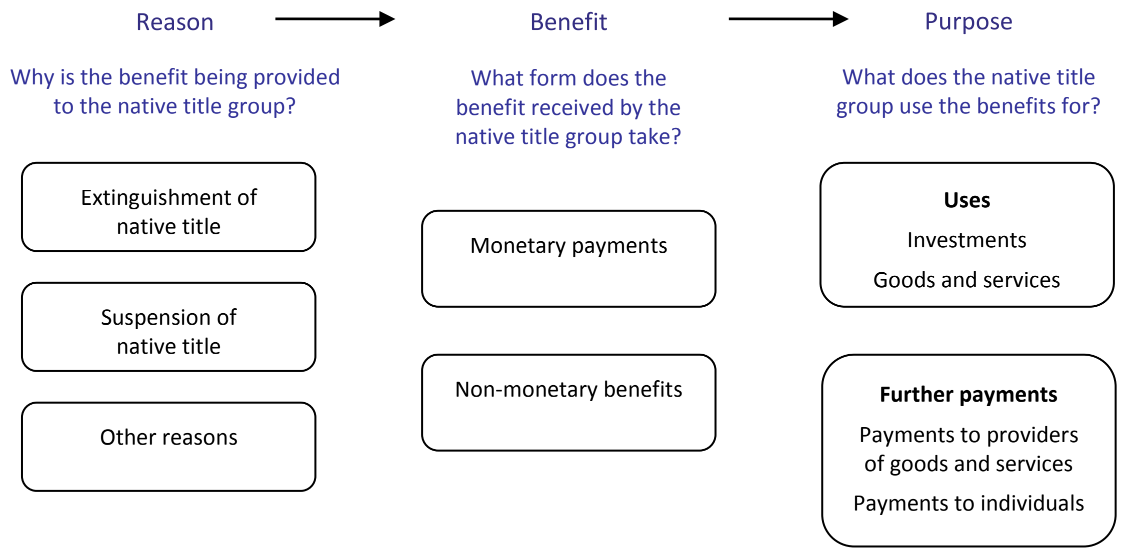
First, native title does not strictly accord with the traditional property law principles used throughout much of the tax law. Australia's income tax system generally involves taxpayers (such as individuals or companies) who earn income through the exploitation of resources and assets (such as labour and real property). In contrast, native title is a unique legal right. It may be recognised, affected or extinguished, but never transferred or rented out beyond the group.

Further, some areas of the law have not been tested extensively through the courts or clarified through other means. This lack of precedent makes it difficult for the Australian Taxation Office (ATO) or tax law specialists to provide native title groups with generally applicable advice.

In practice, a single native title agreement may provide for a range of different kinds of benefits (monetary payments and non-monetary) to native title groups for a range of different and possibly unspecified reasons (including the extinguishment or suspension of native title). Further, each native title group and each agreement will have different priorities and ideas as to the future use of benefits received under a native title agreement (for example, investments or provision of goods and services for the relevant Indigenous community).

Dividing the issue in two can help to unravel some of its complexity. First, what are the potential income tax implications of benefits provided to native title groups? Second, what are the income tax implications of using those benefits for different purposes? This distinction — illustrated by Chart 1 below — will be used throughout the paper to discuss the application of the current tax law and the reform options under consideration.

Chart 1: Basic scheme



2.2 NATIVE TITLE

The *Native Title Act 1993* (NTA) provides for payments to native title holders in relation to past and future acts that affect their native title rights and interests. These payments may be determined through a specified negotiation process, or by the courts. Section 51 of the NTA allows native title holders to request payments in monetary form, in a non monetary form or as a combination of both.

The NTA provides for the validation of certain 'past acts' and 'intermediate period acts' with agreed 'just terms' compensation payable to native title holders. The NTA also provides for payments for 'future acts'. It provides that a future act which affects native title may be valid if the parties enter into an agreement called an Indigenous Land Use Agreement (ILUA) or if it meets the procedural requirements for notification, consultation or negotiation.

Future acts generally fall into two categories: extinguishing acts and acts to which the non-extinguishment principle applies. Extinguishing acts permanently extinguish native title rights and interests such that they cannot revive after the act ceases.[2] An example of permanent extinguishment is the granting or vesting of a freehold title or an exclusive pastoral lease. Where a non-extinguishing act occurs, native title rights and interests revive, with full effect, once the act ceases. As a result, non extinguishing acts may involve the suspension of native title.

The NTA provides that the loss, diminution, impairment or other effect of an act on native title rights and interests should be compensated on just terms. In this way, the legislation tries to equate native title to any ordinary freehold title.

2.3 THE CURRENT INCOME TAX SYSTEM

The tax system requires taxpayers to pay income tax based on their assessable income. Assessable income consists of income according to its ordinary meaning (such as wages earned by individuals) and statutory income (amounts the tax law includes in assessable income). For example, capital gains tax (CGT) includes net capital gains on certain assets in a taxpayer's assessable income as one type of statutory income. These capital gains affect a taxpayer's tax liability.[3]

The income tax system and transfer system have different definitions for what constitutes an individual's income. Payments made under native title agreements to a self-employed member or directly to an individual member of an Indigenous community would be income for income support purposes. However, payments made to an Indigenous community and used by the community as a whole would not be regarded as income of the individual. If amounts paid to an individual are derived from payments paid to an Indigenous community which the community has invested, then the amounts would be treated as income of the individual for income support purposes. In some circumstances, certain one off lump sum amounts that are assessed as compensatory in nature are counted as income in the fortnight of receipt for those receiving a benefit and ignored for pensions.

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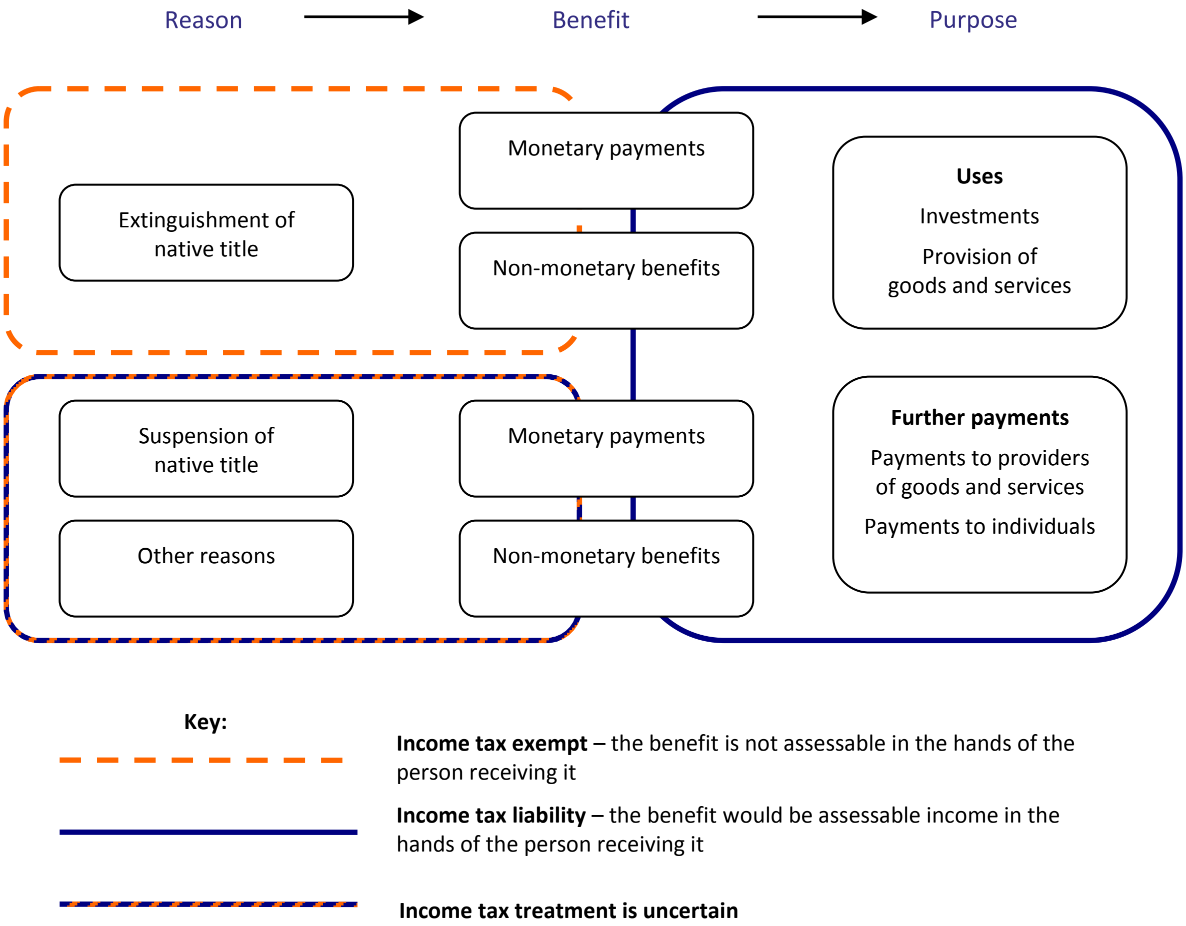
2 Except where sections 47, 47A or 47B of the NTA apply.

3 CGT only applies to CGT assets acquired after 19 September 1985. Land, shares in a company and units in a unit trust, contractual rights and options are all examples of CGT assets. A taxpayer's net capital gain is their capital gains minus their capital losses for the year or any prior year unapplied capital losses, less any discounts or concessions. A capital gain or loss arises from a CGT event, which can include actions such as selling an asset, entering into a contract or loss or destruction of the asset. Exemptions may be provided to exclude certain assets from CGT or to exempt capital gains arising out of certain events.

Compensatory in nature payments that are paid periodically would be assessed as income for income support purposes.

Applying the current rules of the income tax system, payments provided under a native title agreement may or may not be assessable income when a native title group (or members of the group) either receives them or subsequently use the payments for different purposes.[4] Chart 2 illustrates these outcomes, as discussed further below.

Chart 2: Potential income tax consequences



2.3.1 Tax treatment of benefits received for different reasons

Compensation payments for the extinguishment or voluntary surrender of native title rights would generally be regarded as compensation for the loss of a pre-CGT capital asset and therefore any capital gains or losses would be disregarded. However, the form of the payment may affect whether the payment is assessable for income tax purposes. For example, periodic payments may be ordinary income and subject to income tax. Similarly, payments for the suspension of native title could be regarded as receipts in the nature of a return on a capital asset and therefore would normally be regarded as ordinary income.

4 Strelein, L, 'Taxation of Native Title Agreements', AIATSIS, native title Research Monograph No 1/2008, May 2008, Canberra.

Native title agreements can involve benefits other than money, such as education and training commitments, the adoption of heritage protocols or a transfer of freehold title over land. Non monetary benefits received in respect of an extinguishing act would also be compensation for the loss of a pre CGT capital asset and therefore any capital gains or losses would be disregarded. However, a non-monetary benefit received in relation to the suspension of native title may become a CGT asset, and any net capital gain would be assessable in the event that a CGT event (for example, the sale of the asset) occurs in the future in relation to the asset.

A further potential CGT issue arises where a trustee Prescribed Body Corporate (PBC) is established to hold that native title on behalf of a group. To the extent that native title rights and interests are a CGT asset (as are other rights), the transfer of those rights to another entity potentially generates a CGT event. Similar issues may arise where a trustee PBC is dissolved and a replacement PBC is appointed.

A native title agreement may deal with matters other than the extinguishment or suspension of native title rights and interests. Any monetary payments connected with such purposes would be assessable income in the hands of the recipients, as would the net capital gain on any non-monetary benefits.

The potential income tax outcomes outlined above may create uncertainty for native title groups. The current income tax system treats native title as a capital asset capable of being exploited to generate income, rather than as an inalienable, intergenerational and communal right with particular cultural significance. Further, the tax system assumes that benefits under a native title agreement can be clearly apportioned between extinguishment of native title, suspension of native title and any other matters dealt with in the agreement, which may not accord with the agreement making process as experienced by native title groups.

Consultation questions

(a) In the context of your experience, when do the potential income tax implications of an agreement arise in an agreement making process?

(b) What has been your experience in seeking advice or guidance, either privately or from government agencies, on the interaction between the income tax system and native title?

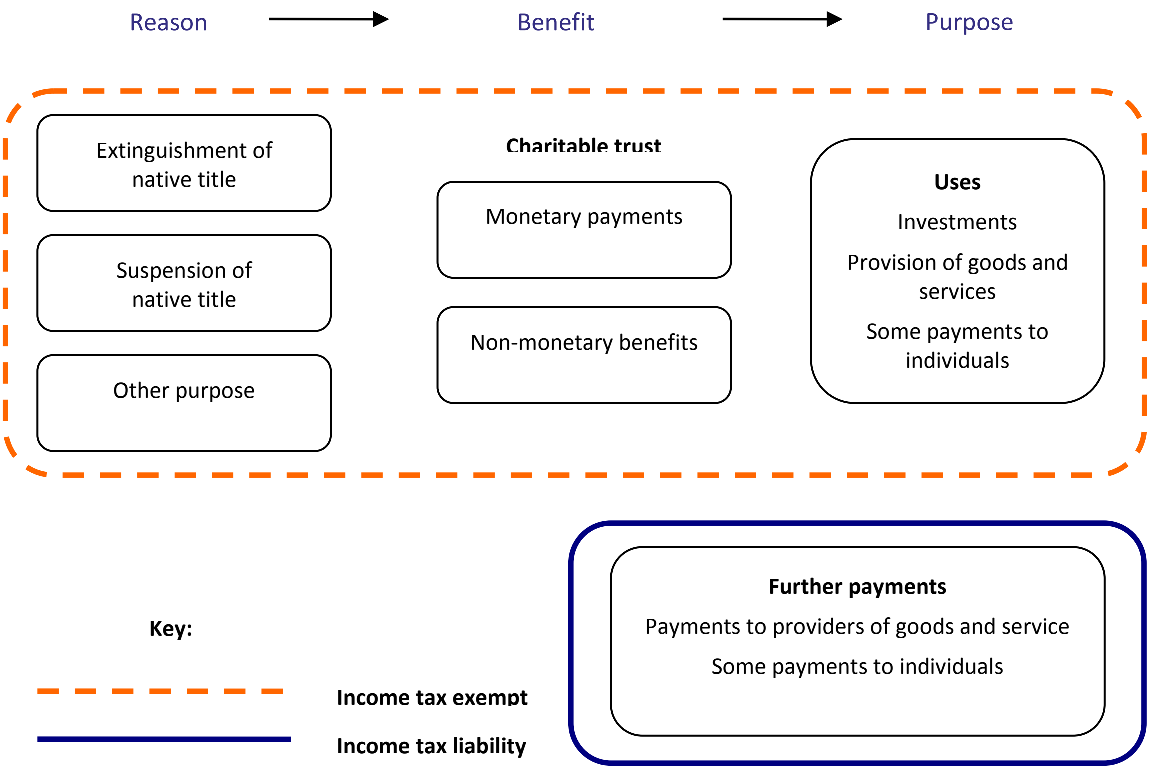
(c) How could government agencies assist to provide greater clarity regarding the tax treatment of payments made under a native title agreement?

2.3.2 Tax treatment of benefits when used for different purposes

To the extent that a monetary payment — either for extinguishment or suspension of native title — is then invested, or used to set up a profitable business, earnings are taxable in the hands of the recipient. That is, the earnings or capital gains/losses would become part of the recipient’s assessable income. On payments made to an individual or a provider of goods and services would form part of their assessable income.

In practice, charitable trusts can assist native title groups in overcoming these potential income tax liabilities.[5] As shown in Chart 3, a charitable trust can ensure an income tax exemption for payments made into the trust and distributions to individuals made from the trust, in accordance with the purposes of the trust.

Chart 3: Charitable trusts



Limitations on the use of charitable trusts

Despite its obvious attractions from a tax perspective, finding ways of working within the charitable trust framework can be time consuming and costly and charitable trusts themselves have a number of limitations in a native title context.

First, it can be challenging for Indigenous groups to obtain endorsement as a tax exempt charity if the trust is to benefit a particular group of native title holders or applicants or a particular part of the Indigenous community, rather than the public as a whole. Further, trust distributions can only be applied for charitable purposes. Such purposes are unlikely to include establishing a business, but could include initiatives such as the provision of scholarships.

In addition, the rule against perpetuities prevents the accumulation of assets across generations. The ability to accumulate assets for the benefit of future generations may be particularly important in the case where benefits have been received by the present generation in respect of the extinguishment of native title rights and interests.

5 In general, the characteristics of a charity are that: it is an entity that is also a trust; it exists for the public benefit or relief of poverty; its purposes are charitable within the legal sense of the term; it is not for profit; and its sole purpose is charitable. An entity needs to demonstrate these characteristics in order to be endorsed by the ATO and obtain income tax exempt status.

The possible reforms discussed below do not include changes to the way charities are treated. The characteristics that entities need to demonstrate in order to gain tax exempt status and the rule against perpetuities are important integrity measures within the income tax system generally. Further, while a wide range of groups within the Australian community use charitable trusts, their use in a native title context may have connotations for Indigenous communities that are inconsistent with their ambitions for the future.

Consultation questions

(d) What has been your experience in the use of charitable trusts as a means of managing payments received under native title agreements?

(e) Within the context of your experience, what structures or arrangements are used to manage the use of payments received under native title agreements?

3. Possible reforms to the income tax system

The level of complexity and uncertainty associated with applying the income tax law to native title agreements may affect agreement making processes and the effective operation of the tax system. In response to concerns about the tax treatment of native title payments, the Government has identified three approaches to reforming the income tax system to minimise complexity and provide more certainty for native title groups. The ability for non-legislative approaches — such as the provision of more extensive guidance information — to reduce complexity and improve certainty will also form part of the Government's consideration.

The first approach canvasses the design of an income tax exemption for payments made under native title agreements. The second approach involves the creation of a new tax exempt entity, an Indigenous Community Fund, to deal with the taxation of benefits when they are used for a range of purposes. A third approach is the native title withholding tax announced in 1998.[6]

These approaches could operate in isolation or in combination. For example, an Indigenous Community Fund could receive payments that have been subject to the native title withholding tax or the income tax exemption.

3.1 Income tax exemption for native title agreements

Design features

Under this approach, legislation would provide that payments made under a native title agreement are exempt from income tax. Monetary payments made under a native title agreement would not be assessable income in the hands of the recipient. Instead, the payment would be either exempt income or non-assessable non-exempt income.[7] In relation to any non-monetary benefits that are CGT assets, these would generally remain as CGT assets but any net capital gain on the sale or transfer of these benefits would not be assessable income.

As part of this approach, CGT amendments could also be progressed that confirm that there are no CGT consequences from native title being vested in a trustee PBC, or where the trustee PBC is dissolved and a new body takes over its functions (or the common law native title holders reassert their rights).

Implementing this approach would require the tax law to define the concept of a native title agreement. One option is to define the term by reference to the NTA. That is, the income tax exemption could apply to any agreement recognised or authorised under the NTA — such as an ILUA. Retaining a nexus with the NTA would act as an integrity check on the system. Further, to the extent that the kinds of agreements recognised under the NTA evolve over time, so will the scope of the tax exemption.

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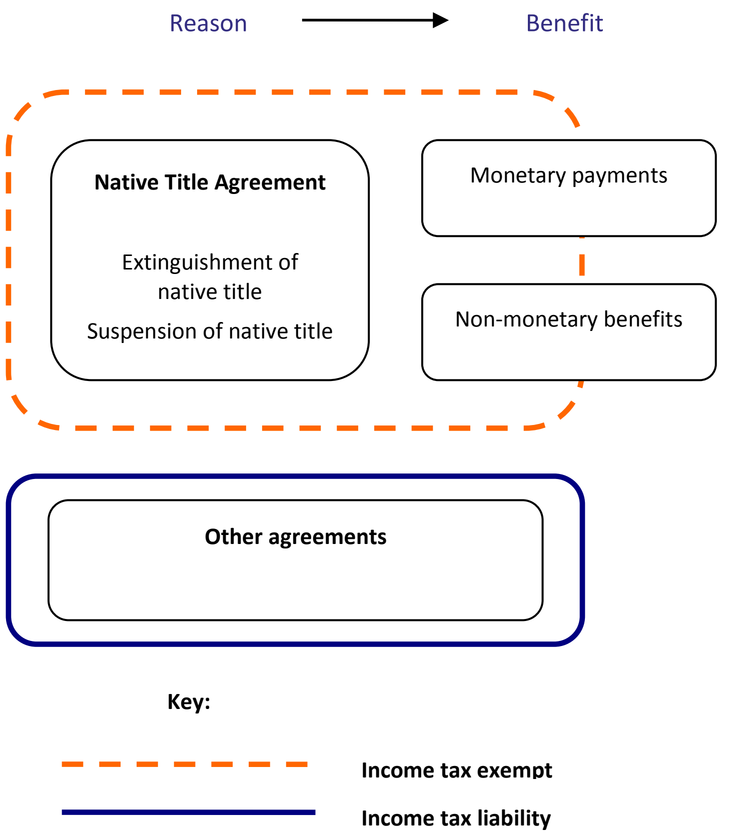
6 At its most basic, a final withholding tax requires an amount to be remitted to the ATO before the rest of the native title payment is passed to the native title group. The residual amount is then income tax exempt (unless subject to other conditions).

7 Non-assessable and non-exempt income is disregarded in determining a taxpayer's assessable income and the extent of their tax losses. That is, it is treated as though it was never income in the first place.

An alternative option would be to allow an independent decision maker (such as the Commissioner of Taxation or the National Native Title Tribunal) to declare that an agreement is a native title agreement to which the income tax exemption extends, based on criteria set out in the law (one of which could be that the agreement is made under the NTA).

As illustrated in Chart 4, the income tax exemption would only apply to those agreements recognised as native title agreements. Other payments that a native title group may receive would be assessable, such as payments under a common law agreement or payments that are otherwise outside the NTA framework.

Chart 4: Income tax exemption



3.1.1 Benefits and limitations

An upfront tax exemption that applies to all payments (monetary and non-monetary) provided for by a native title agreement would improve certainty for native title holders that there is no tax payable on what they receive. An upfront tax exemption would also achieve neutrality between the different components of payments under a native title agreement, thereby minimising the potential for the tax system to distort the composition of benefit packages under an agreement. It also removes the need to distinguish between payments in respect of extinguishment and those in respect of suspension of native title.

While this approach does not overcome some of the limitations associated with charitable trusts discussed above, it does remove the need for charitable trusts, or at least for a charitable trust to be set up from the outset of an agreement.

A consequence of this approach is that an income tax exemption would extend to benefits received for reasons that are not strictly related to either the extinguishment or impairment of native title rights and interests (but are nonetheless covered by a native title agreement). These benefits would ordinarily be subject to income tax and the arguments for making them income tax exempt are less compelling than in relation to benefits received in respect of the extinguishment or suspension of native title. While specific rules could be developed to avoid this result, this would add complexity to the tax exemption approach.

Consultation questions

(f) How would an upfront tax exemption for payments made in respect of a native title agreement impact on the negotiation of agreements?

(g) How should the concept of a native title agreement be defined? Should this concept be defined with respect to the NTA?

(h) Should the purposes for which an exempt payment may be used be prescribed? For example, should there be a restriction on an exempt payment being used for purely private consumption?

3.2 Indigenous Community Fund

3.2.1 Design features

To provide greater certainty and clarity around the tax treatment of payments when they are used for different purposes, a new kind of entity could be established under legislation. For discussion purposes, this new entity will be referred to as an 'Indigenous Community Fund'.

At its most basic, payments received into the fund would remain tax exempt when they are used for certain purposes. The enabling legislation could specify a range of design features including:

- the kinds of payments the fund can receive;
- the purposes (or uses) of the fund; and
- its governance arrangements.

All of these features will have an impact on the compliance costs that may be involved for those associated with the fund and how effective the fund may be in delivering certainty and greater clarity for native title groups.

Payments received by the fund

The fund could receive payments made under native title agreements (that is, those amounts covered by the possible income tax exemption discussed above) and payments associated with the fund's overarching purpose (including any income from investments it may undertake). Investment earnings would ordinarily be assessable income of the fund but would be exempt if paid into the fund and used for certain purposes.

Uses of the fund

The purposes of the fund would define the range of uses that amounts received into the fund could be used for while retaining its tax exempt status.

One approach could be for the legislation to provide that the fund is to be used for the benefit of a particular native title group, a number of such groups and/or Indigenous Australians more generally. The legislation could also provide that this general purpose includes more specific activities such as:

- the accumulation of assets and resources for current and future generations of specified native title holders;
- the protection of the environment;
- the protection, maintenance or advancement of Indigenous cultural heritage;
- supporting education and training;
- other purposes beneficial to all of those for whom the fund was established; and
- the administration and governance of the fund.

This description is not exhaustive. Stakeholders are encouraged to consider what other activities an entity like the fund may want to undertake and how this could be built into a legislative statement of the fund's purpose.

Where amounts are paid from the fund to entities that are not members of the native title group or their representative body (such as health professionals or service providers), such amounts would be taxable in the hands of those third parties (that is, treated as part of their assessable income). Further, any investment income derived by the fund would be assessable unless reinvested into the fund for use towards certain purposes.

This purpose would not necessarily rule out a payment to an individual. But such payments would only be income tax exempt, and excluded from being assessed as income for income test purposes, to the extent that the payments were supported by the fund's purpose (for example, the provision of medical services). However, where a link between the payment and the purpose of the fund does not exist it would form part of that individual's assessable income and for income test purposes.

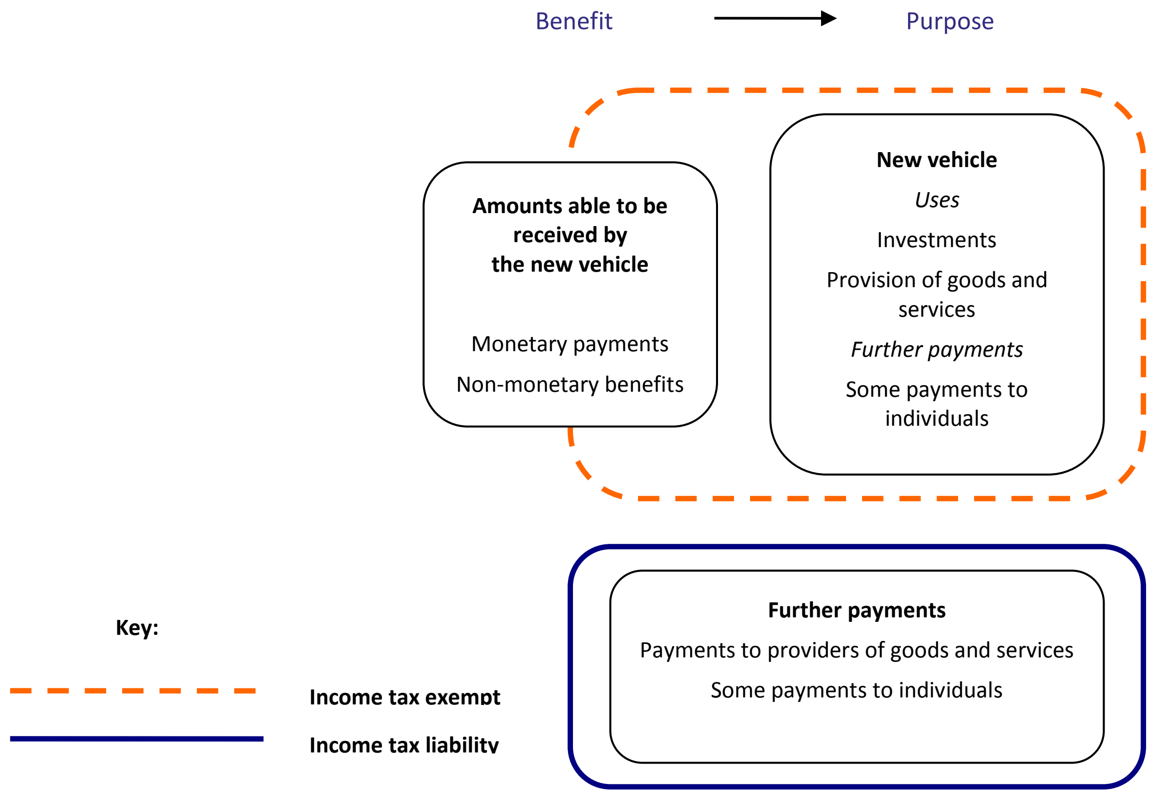
Governance arrangements

A further issue that would need to be resolved is what kind of governance requirements would apply to the fund. This design feature will need to balance the need to ensure the integrity of the fund with ensuring that the groups for whom the fund is established are able to play an active role in directing the uses of the fund.

One option would be to require incorporation under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* and potentially to specify new or additional requirements specific to Indigenous Community Funds (for example, qualified independent directors). Alternatively, the fund could be required to operate as a discretionary or possibly a non discretionary trust.

However, it may not be necessary to specify a particular legal structure for the fund. Instead, legislation could prescribe certain features that must be present in the governance arrangements of these kinds of funds. For example, legislation could require that decision making about the use of the fund is to involve representatives of the groups for whom the fund has been established (or by the delegate of that group).

Chart 5: Indigenous community fund



3.2.2 Benefits and limitations

A new tax exempt entity, such as the Indigenous Community Fund described above, would preference particular groups (that is, native title groups) over others and will only be feasible if it contains sufficient integrity measures that minimise the opportunities for manipulation while minimising the compliance burden it imposes on those responsible for its administration.

As noted above, a number of native title groups have already established charitable trusts and other means of holding and investing payments they have received under native title agreements. To the extent that these groups decide they want to move these arrangements into a new Indigenous Community Fund, there may be transitional costs involved. Even for new funds, there would be setup costs. However, the Government can help to reduce these transitional or setup costs by making guidance material, training and other resources available.

The potential transitional costs aside, the ability for native title holders to consolidate payments they have received under a number of native title agreements into a single pool is one of the fund's main potential benefits. It would allow native title holders to realise economies of scale in the management of their benefits.

Further, a new tax exempt entity, as outlined above, would allow native title groups and Indigenous communities more broadly to maximise the value they are able to realise from the payments they received through the native title system. A governance model that encourages a high level of participation in decision making is also consistent with recognising the rights of these groups to exercise choice in how these payments are applied.

Consultation questions

(i) If development of a new tax exempt vehicle is progressed further:

- (i) What payments should such a fund be able to receive? Should the fund only be allowed to receive payments made under a native title agreement or should it be allowed to receive other payments?
- (ii) Do you agree with the proposed permitted uses of the fund? What other uses could be considered?
- (iii) What legal form should the fund be required to take?
- (iv) What kinds of governance requirements should the fund be subject to?
- (v) How would the establishment of a new tax exempt vehicle impact on existing agreements?
- (vi) What kinds of transitional arrangements would be required?

(j) Within the context of your experience, what difference would a new tax exempt vehicle make to native title groups and Indigenous communities?

3.3 Native title withholding tax

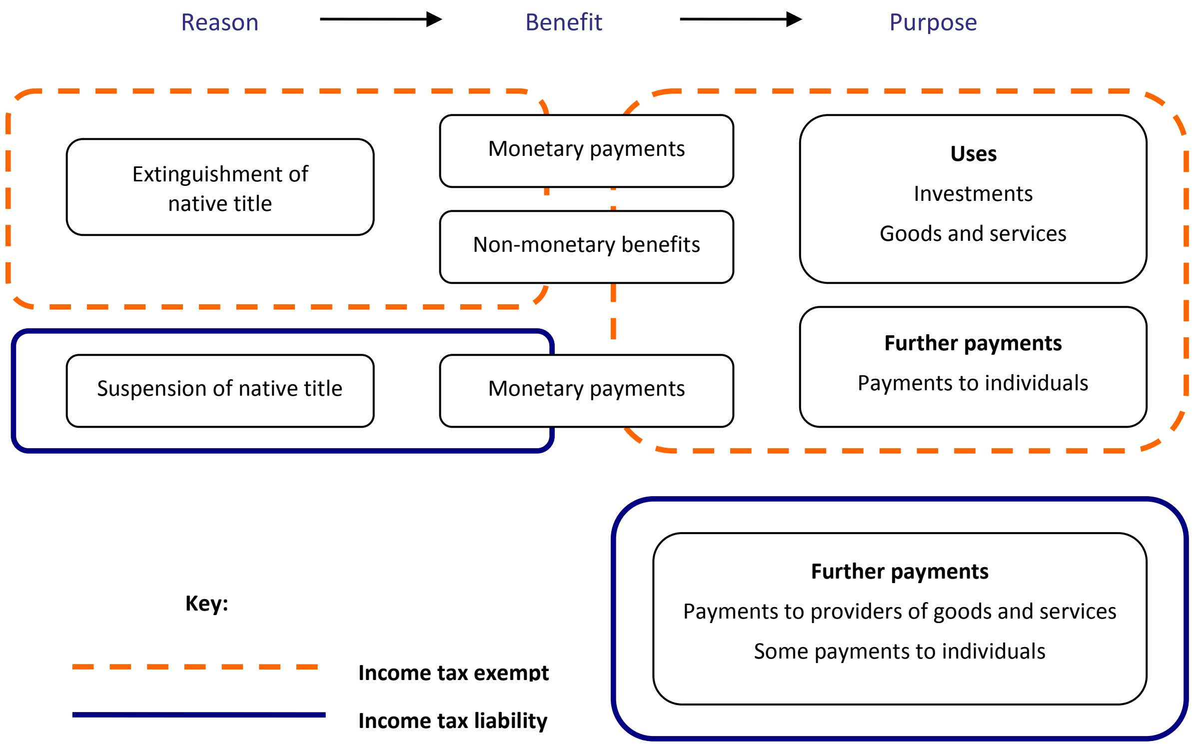
3.3.1 Design features

In 1998, the previous government announced that it would establish a native title withholding tax (NTWT). As announced, the withholding tax would require parties who make payments for the suspension of native title rights and interests to withhold an amount of tax (4 per cent was the rate proposed) and pass it to the ATO before the payment goes to the native title holders. The rest of the payment would then be income tax exempt if on-distributed to the native title holders or their representative body (further conditions may also be applied to the use of the payment).

The NTWT was modelled on the Mining Withholding Tax (MWT) which is currently levied on 'mining payments' made to Aboriginal people and/or a distributing body (for example, a Land Council) in relation to the use of Aboriginal land, as defined in the *Income Tax Assessment Act 1936*, for mining and exploration. The current rate of MWT is 4 per cent. Amounts from which the tax has been withheld are treated as non assessable, non-exempt income. The extent to which there is an overlap in the land and activities covered by the MWT regime and the NTWT is unclear. It seems that a determination of native title does not invoke the MWT but that the MWT could still apply to land over which a determination of native title has been made if it also meets the definition of 'Aboriginal land'.

Like the MWT, the NTWT would only apply to monetary payments or monetary payments applied to provide non-monetary benefits. Any non-monetary benefits provided in respect of the suspension of native title rights and interests could continue to have their tax status determined on a case-by-case basis under the current income tax law or could be exempted. As discussed below, the benefits and limitations of the NTWT have led over the years to its introduction being reconsidered.

Chart 6: Native title withholding tax



3.3.2 Benefits and limitations

A final withholding tax model (even if only applied to monetary payments) would have a number of benefits. By imposing the obligation to remit the withholding tax on the entity making the payment, the compliance costs imposed on native title groups would be reduced. Such an approach is also neutral about the future uses of the payment, assuming no integrity measures are implemented. That is, once the withholding amount is remitted to the ATO, the residual could be applied to any use the native title group sees fit and may retain its tax exempt status. It also has benefits from a compliance perspective, as all parties gain certainty about their tax obligations and only a few taxpayers are involved in making payments to the ATO.

Applying a different tax treatment to payments for suspension of native title rights requires that agreements clearly identify where a payment is made for impairment and where it relates to extinguishment (or other reasons). This may require apportionment of payments which could affect structuring of the agreement.

In accepting that native title rights and interests are *sui generis* (that is, unique), it could be argued that any compensation linked to both the extinguishment and suspension of such rights is itself unique and should be treated by the income tax law as such. However, an alternative argument would note the fact that the right giving rise to certain payments, or the payments themselves, are to be considered unique does not justify a tax concession by itself. Applying a positive but low rate of tax achieves consistent treatment with payments for rights of access, but implicitly assumes that tax would be payable on some, if not all, of the benefits in the future (even though, in the case of benefits for extinguishment, this is not the case).

Consultation questions

(k) Within the context of your experience, how would a NTWT affect:

- (i) the negotiation of native title agreements?
- (ii) the form of benefits provided under native title agreements, if a NTWT only applied to monetary payments?
- (iii) the management of benefits received under a native title agreement?

3.4 Worked example

The following hypothetical case study illustrates each of the proposed approaches.

3.4.1 Facts and circumstances

A native title group enters into the following agreements:

A settlement agreement with the relevant State government that results in:

- native title rights being recognised over a particular area by consent;
- native title being extinguished over another area by consent; and
- a lump sum of $A being paid to a trustee PBC under an ILUA.

A future act agreement (under section 31 of the NTA) with a mining company to allow exploration that results in a lump sum of $B being paid into a separate, bare trust.

A separate ILUA with a mining company to allow the extraction of resources on native title land which results in:

- the group's native title rights being suspended for a period of 60 years;
- an up-front payment of $C to be paid into a separate charitable trust;
- periodic payments of $D to be paid annually into the charitable trust.

Income tax exemption

All of the native title group's agreements would be recognised under the NTA. Assuming the income tax exemption applies to such agreements, all of the amounts would be either exempt income or non assessable, non-exempt income and therefore would not be assessable income in the hands of the PBC. Further, it would mean that amounts B, C and D could all be paid to the PBC without the need for charitable trusts to be established.

Indigenous Community Fund

Amounts A, B, C and D could all be paid into an Indigenous Community Fund established for the benefit of the native title group. An income tax exemption is only available for payments coming out of the fund that are applied for the purposes of the fund. The amounts would then be exempt if distributed for particular purposes.

Native title withholding tax

Under the native title withholding tax, 4 per cent (or some other percentage) of amounts B, C and D would be withheld and remitted to the ATO by the mining company. Amount A would be income tax exempt, unless the withholding tax was extended to apply to extinguishment in which case 4 per cent of amount A would also need to be withheld and remitted to the ATO.

4. IMPLICATIONS FOR BUSINESS AND NON-GOVERNMENT STAKEHOLDERS

4.1 INTRODUCTION

The following paragraphs outline the anticipated implications for business and other non-government stakeholders of the above reform options. It is not expected that any of the reform options would have significant implications for such groups.

4.2 THE CURRENT INCOME TAX SYSTEM

Companies or non-government stakeholders making payments to native title groups under a native title agreement may be able to deduct those amounts under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).[8]

This tax treatment was upheld by the Federal Court in 1997. In *Cape Flattery Silica Mines v Federal Commissioner of Taxation*[9] it was held that the compensation paid by a mining company to a group of Traditional Owners was deductible under section 8-1 of the ITAA 1997. In that case, the compensation took the form of a recurrent payment. This seemed to persuade the court that the payments were income-related expenses. This is the only case to consider the issue of deductibility of payments made to a Traditional Owner group. Further, the ATO has not had cause to challenge any deductions that may be being claimed for such payments (whether under section 8-1 or elsewhere in the tax law) as part of its compliance activity.

There may be situations where a business considers that access to land or resources is crucial to its business framework. In such a situation, payments to secure that access on an ongoing basis may be capital in nature.[10] If a payment is considered to be capital, then a deduction may still be available under the uniform capital allowance regime in Division 40 of the ITAA 1997. Specifically, mining companies may be able to access the project pooling provisions in Subdivision 40-I.

4.3 POSSIBLE REFORMS TO THE INCOME TAX SYSTEM

Providing an income tax exemption to the native title group should not mean that businesses would be denied a deduction in respect of any payments they may make under a native title agreement. That is, any such payments could still be considered to have been necessarily incurred by the business in carrying on its affairs.

The creation of a new income tax exempt vehicle is likewise expected to have a minimal, if any, effect on the ability of industry stakeholders to access deductions in respect of their native title payments.

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8 Section 8-1 provides a general deduction for expenses that are not capital, private or domestic in nature, and are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

9 *Cape Flattery Silica Mines v Federal Commissioner of Taxation 97* ATC 4552.

10 *Sun Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337.

The imposition of a NTWT would require industry stakeholders to withhold an amount of taxation from the native title payments which they distribute to native title groups, and remit it to the ATO. This would be conducted in a manner similar to the PAYG withholding tax system. On this basis, the imposition of a NTWT would be expected to have minimal compliance costs for industry.

Consultation questions

(l) Would adopting one or more of the options outlined above change the way in which you approach agreement making?

(m) Would adopting one or more of the options outlined above affect the nature of payments you provide?

5. INDIGENOUS ECONOMIC DEVELOPMENT

The Government is committed to closing the gap on Indigenous disadvantage. Promoting Indigenous economic development through the creation of new business ventures and employment opportunities plays a key role in achieving this objective. Generally, the Government considers that direct spending programs rather than tax incentives are a better means of providing targeted business support. Tax incentives risk promoting investments made primarily for tax benefit to the investor, rather than based on the underlying viability of the business or project.

Further, the use of existing philanthropy tax incentives (such as deductible gift recipient status) to promote business investment could have a range of undesirable consequences. However, it is possible that the existing deductible gift recipient categories could be better adapted to reflect the needs of Indigenous communities.

5.1 DEDUCTIBLE GIFT RECIPIENTS (DGRS)

5.1.1 The current income tax system

A deductible gift recipient (DGR) is an organisation that is entitled to receive income tax deductible gifts. Division 30 of the ITAA 1997 allows taxpayers to claim deductions for gifts or contributions made to DGRs. In order to be a DGR, an organisation must either fall within one of the general DGR categories set out in the gift provisions of the ITAA 1997 or be specifically listed by name in the tax law.

The provisions for becoming a DGR deliberately constrain DGR status to a closely targeted subset of organisations. Examples include public benevolent institutions, public universities, public hospitals, school building funds, public libraries, and registered cultural and environmental organisations.

The DGR framework currently provides considerable support for Indigenous community-based organisations. Organisations which operate for the public benefit to advance the condition and welfare of Indigenous Australians already meet the eligibility criteria for many of the general DGR categories. Examples include Indigenous health promotion bodies, women's shelters, rehabilitation services, Indigenous cultural organisations, family support services, and environmental harm prevention and research organisations.

The Government has received submissions seeking the expansion of the DGR concession to include Indigenous business development activities. However, extending DGR status to organisations that can carry out business development activities would undermine a longstanding principle that the DGR concession is a philanthropic concession. Granting DGR support for business development activities would have significant policy implications as it would extend the philanthropic tax concession to organisations which operate a quasi commercial activity. Extending DGR status in the tax law generally involves an uncapped and uncertain cost to revenue.

5.1.2 Possible reforms to the income tax system

Concerns have been raised that some Indigenous organisations are having difficulties seeking endorsement as DGRs as their activities do not fall within a single DGR category. Extending the DGR concession to include Indigenous business development activities is not supported. However, there may be a case for creating a new general DGR category to include Indigenous organisations that carry out activities across multiple DGR categories.

This approach would overcome the difficulty that the purposes of philanthropic organisations in Indigenous communities are not consistent with the distinct eligibility criteria of the general DGR categories and their objectives fall into multiple DGR categories. However, this approach could also set a precedent for expanding access to the DGR concession to other groups and would require careful consideration.

Consultation questions

(n) How would a new DGR general category for Indigenous organisations that carry out activities across multiple DGR categories impact on the ability of such organisations to obtain DGR status?

6. CONCLUSION

This consultation paper has provided an overview of the current income tax law and its interaction with the native title system. It has set out several reform options for consideration and discussion.

Stakeholders are encouraged to provide feedback on their experience with the interaction between the tax and native title systems, and in response to the consultation questions. This feedback will be important in helping the Government decide how to proceed.