



# Native Title Services Victoria Ltd

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Dear Manager, Corporate tax Unit

## **Comments on the Exposure Draft for Tax treatment of native title benefits**

Native Title Service Victoria Ltd (NTSV) is the recognised native title services provider for the State of Victoria.

On 30 November 2010, NTSV provided a submission on the consultation paper "Native Title, Indigenous Economic Development and Tax".

Attached are our comments on the recent Exposure Draft for Tax treatment of native title benefits, including recommendations for changes to the proposal.

If you have any queries, please do not hesitate to contact me on (03) 9321 5300.

Yours faithfully,

Ben Gordon  
Economic Development Advisor

**Native Title Services Victoria**  
**Submission on**  
**Tax Treatment of Native Title Benefits**

**24 August 2012**

**INTRODUCTION**

1. Within the narrower scope than the 2010 consultation NTSV is generally comfortable with the approach taken. However, NTSV considers that the broader issues remain to be considered and recommends further work on these issues.
2. NTSV also recognises that the Exposure Draft, properly, explicitly identifies the *Traditional Owner Settlement Act 2010 (Vic)* within the agreement regimes capable of attracting the NANE tax treatment.

**SPECIFIC ISSUES**

3. Income from investment of settlement funds
  - 3.1. NTSV is concerned that exclusion of investment income from attracting NANE status, as proposed in the Exposure Draft, is contrary to public policy objectives<sup>1</sup> and retains perverse incentives for Aboriginal corporations to structure and manage their affairs in a manner contrary to supporting economic growth and development.
  - 3.2. The exclusion of investment income from attracting NANE status will undermine the development of strong and rational decision-making, around the objective of long-term economic development and growth. Rather, under the model proposed, it is likely that organisations will continue to seek charitable status in order to gain a tax free status, and will not be encouraged to invest in the economic prosperity of the region.
  - 3.3. The proposal undermines trustee's responsibilities to perfect the trust relationship, and fulfill the common law and statutory requirements, with particular focus on investments.
  - 3.4. The proposed regime does not provide a solid platform for the neutrality of decision-making, but rather skews the incentives for distributing bodies, holding entities and trustees away from risk managed investment and wealth creation across generations, and in instead:
    - towards adopting organisational forms that are charitable in structure and nature;
    - towards immediate distribution; and
    - away from adopting organisational models that can help manage risks.

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<sup>1</sup> Including commitments to 'Close the Gap' and foster Economic Development among Aboriginal communities.

- 3.5. While the NTSV supports the adoption of charitable structures where those structures are best suited to fulfill the objects of the Aboriginal corporation, we consider that it is desirable for a broader suite of corporate vehicles to be entertained particularly in light of objectives around economic development and growth.
- 3.6. Such vehicles are less likely to be considered if there are limited incentives to do so in light of a finite settlement sum.
- 3.7. Specific issues are outlined below.

#### 4. *Trusteeship and investment*

##### Tax neutrality over time

- 4.1. A fundamental principle within trusteeship, with both common law and statutory underpinnings, is preservation of the capital (other than through distribution). This requires trustees to invest money. A second fundamental principle for any trustee is to ensure the fairness of distribution, including for present and future beneficiaries.
- 4.2. Therefore, investment income that preserves the value of the funds for the members/beneficiaries, including through capital gains and investment income streams of the corporation should be treated as NANE. This is the purpose for which it was provided – to be NANE for the beneficiaries. But under the current proposal set out in the Exposure Draft, only those who receive the money now will benefit from the agreed amount (future beneficiaries will receive an amount that is of a lower value).

##### Tax neutrality between organisations

- 4.3. The NANE treatment of income should apply to subsidiaries of a distributing body. If the funds are managed, invested, held on behalf of the Trust/overall settlement body by a 100% owned subsidiary then, this is in effect, the same body and should have the same tax concessions – independent of the nature of that body (eg if it is a limited liability company). This would preserve the tax neutrality, while providing Aboriginal corporations with broader options of the vehicle for the investment.
- 4.4. A subsidiary company's income from an ILUA is NANE income. This increases the balance sheet of the subsidiary body. If this subsidiary now came back into the parent, it would have increased in value. This should be able to be moved back into the parent organisation as if it were not any different to maintain the tax neutrality between the two organisations.

##### Capital gains and income tax

- 4.5. The Exposure Draft, including the accompanying explanatory material, is not clear as to whether the NANE status applies equally to the nature of the funds – e.g. of capital gains, investment and operational income streams. The explanatory note signals that income may be transferred to certain persons or bodies and remain NANE, and includes capital gains. However it is not clear how this capital gain would occur and whether it is of a different nature to the income gained on other investments.
- 4.6. An instrument such as a bond, for example, could be sold with a capital gain but could also derive income. One would be subject to tax, the other is considered NANE.

- 4.7. This could impact on the investment approach taken by Aboriginal corporations and in effect change the way in which they conduct business and manage and distribute funds. Further, it conflicts with the traditional approach of managing risk by having a portfolio of longer and shorter term returns from investments, emphasising a need to have a mix of income generating and capital growth investments.

## 5. *Development and investment*

- 5.1. Native title settlements in Victoria are increasingly focussed on kick-starting the capacity of Aboriginal corporations to become economically self-sufficient and to encourage and support economic development in regions where they are based. However, Aboriginal corporations often seek charitable tax status in order to achieve tax neutrality over time and to be tax efficient as investment vehicles.
- 5.2. A tax approach that is parallel to the 'charitable status' but without the charitable status constraints (particularly the public benefit test, and the charitable objectives) would have no direct consequences on the government tax revenue (as most organisations are employing this status now). Such an approach would encourage Aboriginal corporations to consider alternative corporate structures, which may, in the long term, be more appropriate vehicles to drive economic development and in turn, enhance regional economies.
- 5.3. The treatment of subsidiaries in this case – that have the same tax status as the parent – would also enable a stronger investment approach, whereby risk can be more easily fenced off, enabling investment and commercial behaviour.

## 6. *Equity*

- 6.1. The Victorian native title settlement context includes among other issues, that the settlement bodies are strongly long term and intergenerational, with a membership/beneficiary pool that has significant growth in the population base and which is different from the usual 'shareholding' base of a company (where there is ability for shareholders to come and go based on the shareholder value).
- 6.2. In this context, it is understood that the settlement amount is intended to provide the basis for on-going capital. In order to retain its value to the beneficiaries (including future beneficiaries), it needs to grow not only at a rate relative to the cost of capital and inflation, but also be cognisant of beneficiary population growth.
- 6.3. Without investment, the lump sum amount of today is worth less tomorrow. Investment needs to reach at least above the cost of capital and inflation to maintain value. In the context of the intergenerational perspective, handing assets on to a growing population base, the asset base needs to grow faster than its value depreciates.
- 6.4. Therefore, it is not appropriate to adopt a regime that mirrors the general approach to income tax from investment. A tax regime that seeks to treat such organisations on a similar footing to other organisations is inequitable and further erodes the value of the settlement by incentivising a short term, distribution oriented focus, undermining approaches more apposite to long-term growth and development.

- 6.5. The equity between generations is important in the sector that seeks intergenerational wealth creation and value transfer. Aboriginal corporations in Victoria have therefore tended to create the equity by adopting charitable structures. This approach has tended to weaken the propensity for investment and economic growth.

#### *7. Application to money held under other authorities*

- 7.1. Section 78 of the *Traditional Owner Settlement Act 2010* (Vic) provides that the Minister on behalf of the State may enter into a funding agreement as a part of the settlement agreement, and that this may be paid into a trust. The Victorian Traditional Owner Trust has been established with trustees that are appointed by, and report to, the Attorney-General and hold the money on trust for the Traditional Owner groups.
- 7.2. It is not clear whether this body falls within the 'definition of a distributing body' set out in the Exposure Draft. However, it has a clear mandate to hold money until it is to be expended as determined by the appropriate Aboriginal corporation – except in so far as that would be a breach of trust. Even as a distributing body, the State determines the body in which the money is held, appoints and monitors the trustees and has a level of direction over the investment, which is held at the very lowest end of the risk/return spectrum.
- 7.3. In this context it appears anomalous for the income tax treatment to mirror the arrangements of other investment funds.

#### *Application to money held by Native Title Service Providers*

- 7.4. The situation could arise where funds are held for a period of time by a Native Title Service Provider for native title holders /traditional owner groups. This could occur where money, including from payments under an Indigenous Land Use Agreement or agreements under the 'right to negotiate' provisions, is not held in trust, but is simply held pending the establishment of a trust by the native title group. The Native Title Service Providers are not identified within the definition of an Indigenous holding entity (as either a distributing body or a trust) and this money may not be treated as NANE.
- 7.5. In addition, even if this money is included as NANE when received by the Native Title Service Provider, the capital and income are ultimately delivered to the body it has been collected and held on behalf of, and therefore ought to remain as NANE.

### **SUMMARY AND RECOMMENDATIONS**

#### **8. Summary**

- 8.1. In summary, the NTSV supports the principle that income derived from settlements be treated as NANE.
- 8.2. Further, NTSV considers that where this is held by a body and either earns investment income or receives a capital gain, that this should also be NANE. The money is held on the principle that it was intended to be tax free. The income derived from this is not 'investment income' in the sense that it would ordinarily be included in the assessable income of the investor. In this context the income is largely held until decisions are made as to how the income can be used to best effect (and this is particularly pertinent in the case of the funds held by the Victorian Traditional Owners Trust and the NTSV).

- 8.3. The widening of income that is NANE recognises several key features and contextual matters, including:
- money held on trust is subject to the law relating preserving the capital value, and distribution to beneficiaries fairly and equitably, including through generational change and population growth;
  - the funds are provided with an intention to promote economic development opportunities, and need to therefore enable and encourage income derived from this opportunity, without the restrictions imposed under the charities regime, which are likely to be retained unless there are benefits to adopting another regime;
  - the transparency of the tax regime, and in particular the neutrality and consistency across time and organisational forms, to ensure that the decision-making of the Aboriginal corporation best reflects the intended outcomes, including intergenerational development;
  - the use of subsidiaries and other forms that enable investment and help to manage risk ought to attract NANE status as long as the distributing body retains control of that organisation and receives the net income generated
  - the incentives are skewed to distribute to individuals or to expend funds where the gains from investment income remain taxable. This includes the differential approach to capital gains and income.
- 8.4. This submission has focused on investment income, and further issues and examination is warranted in consideration of NANE or other tax considerations in relation to income from operating activity.

## **9. Recommendations**

- 9.1. Amend the proposal to reflect that income derived from investment activity – whether income or capital gains – is NANE.
- 9.2. Explicitly allow income to remain NANE where the income is distributed to or derived from a subsidiary which is controlled by the distributing body.
- 9.3. Explicitly include money held by Native Title Service Providers for Aboriginal corporations or Traditional Owner organisations within the NANE treatment.
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